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INVISIBLES: INSURANCE

Insurance in developing countries: review of developments in 1986-1988

Study by the UNCTAD secretariat

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CONTENTS

		Paragraphs
Introduction		1 - 4
Chapter		
I.	Insurance systems and market changes	5 - 49
	A. General considerations	5 - 23
	B. Developments at country level	24 - 49
II.	Obstacles to the expansion of domestic insurance companies and operations	50 - 80
	A. The macro-economic environment	52 - 60
	B. Technical factors	61 - 71
	C. Other deficiencies	72 - 74
	D. Low level of insurance capacity	75 - 77
	E. External environment	78 - 80
III.	Measures aimed at the strengthening of domestic markets	81 - 116
	A. General considerations	81 - 93
	B. Some country developments	94 - 110
	C. Developments regarding life and health insurance	111 - 116
IV.	New regulations on solvency, administration and contracts	117 - 151
	A. General considerations	117 - 131
	B. Some other country developments	132 - 151
V.	New developments in the field of retention capacity and reinsurance	152 - 193
	A. Developing countries as reinsurance buyers	153 - 175
	B. Developing countries in their capacity as reinsurance providers	176 - 193

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INTRODUCTION

1. At its second session (April 1967) the Committee on Invisibles and Financing related to Trade requested the Secretary-General of UNCTAD "to carry out at least once every two years reviews of developments in insurance, with special reference to developing countries". 1/ The present study, covering the period 1986-1988, has been prepared pursuant to this request.

2. As in the past, part of the data needed for the preparation of this study was supplied to the UNCTAD secretariat by the Governments of developing countries in response to a request made by the Secretary-General of UNCTAD. This information has been supplemented by data collected from very diverse private sources, especially trade journals and periodicals. Information gathered by three consultants on regional developments in insurance was also considered. It has not, of course, been possible to verify the accuracy and coverage of the information obtained in this way.

3. This study does not claim to provide comprehensive information. The information included has been selected mainly on the basis of its relative importance to the development of the insurance sector in developing countries. More particularly, it tries to identify the factors which have potential growth at the individual and collective levels.

4. Chapter I deals with domestic insurance markets and their structural development. Chapter II includes information on the obstacles to the expansion of domestic insurance companies and operations in developing countries. Chapter III concerns new measures adopted with a view to strengthening these markets. New regulations pertaining to the solvency of insurance concerns and the security of insurance operations are described in chapter IV. New developments in the field of reinsurance and its relationship with the retention capacity of the markets are covered in chapter V.

Chapter I

INSURANCE SYSTEMS AND MARKET CHANGES

A. General considerations

5. During the period under review, several developing countries have changed significantly the structure of their insurance markets. Most notable among these changes has been a general roll-back of policies instituted in the past to protect the insurance sector. In some countries, ownership of insurance companies has been opened to the private sector, domestic or foreign, in others the traditional rule that domestic property and liability may only be insured with companies in the domestic market has been relaxed. The obligation that local insurers have to take out reinsurance with a State-owned institution has also been removed in a number of countries and basic reforms on licensing, tariffs, contracts, and shareholding have been introduced.

6. This trend is in marked contrast to that of the 1970s, which saw the emergence of "domestication" policies for insurance in the developing countries. As a result, the dominance of foreign companies was gradually terminated, and many countries stopped the entry of new foreign companies. Others required the existing foreign companies to go into joint ventures with local companies. In line with an import-substitution policy, companies of the private sector, where it existed, were closely regulated: investment, tariffs, policy conditions and other activities were put into a rigid framework of internal rules. In some countries, the Government set up partial or total monopolies to handle reinsurance business. The companies' margin of freedom in respect of the selection of their reinsurers was otherwise tightly curtailed. As suggested above, the pendulum appears to have swung back in the middle of the 1980s, and more particularly during the period under review.

7. Although it is difficult to determine scope, pace and outcome of the reforms a general conclusion can be drawn: policy shifts, in the countries where they have occurred, seem to be partly due to disappointment with traditional insurance patterns and reflect expectations that new concepts, giving larger room to reliance on market forces and outward-looking policies, will work better. More particularly, these concepts are based on the conviction that changes are indispensable if the market is to operate more efficiently and to provide better insurance services - services which should compare favourably, in terms of quality, policy conditions and price, with those available in other markets.

8. Two connected factors have often given impetus to these moves: on the one hand the insured community has become more demanding in terms of price and quality of the insurance covers offered and, on the other hand, the insurance industry, shaped by old market structures, has proved less effective and competitive than expected. The alternative facing many developing countries was, and still is, whether to let the domestic companies overcome their learning period and keep them shielded from outside forces until they no longer qualify as "infant industries" and are able to stand up to international competition, or whether this course of action is too expensive for the country, in terms of losses by the insurance industry bearing on government budgets, costs to the insured community and poor quality of the services. The issue has often been raised by exporting industries in the

countries concerned, for which reliance on the local markets resulted in higher insurance costs, which in turn increased production costs and resulted in a loss of competitiveness with negative effects on the terms of trade. The issue was therefore part of efforts to improve the general effectiveness of economic policies.

9. As suggested above, the result has been that some countries, where the insurance industry had been nationalized, are now open to the private sector. Some have enacted legislation allowing the entry of foreign insurance companies, sometimes on a joint-venture basis with local capital. Some countries are even testing the ground for self-regulation.

10. A major inducement for liberalization has been provided by international lending institutions, generally under "conditionality" programmes. This is particularly so in Africa, where "the World Bank is urging insurance monopolies to accept foreign participation in their shareholding". 2/ More generally, "about 30 World Bank financed projects are designed to assist Governments in privatizing state enterprises through sales, leases or management contracts". 3/

11. Decisions to sell or privatize government-owned insurance companies have often been prompted by the financial losses that these companies incurred and by budget constraints - combined with adverse balance-of-payments positions and a growing debt burden. In one or two cases, the sale of companies has been directly linked to the need to raise foreign exchange to pay for external liabilities, sometimes within the framework of a "debt-equity conversion" programme. Also, sales of domestic companies have often been followed by renewed attempts of expatriate companies to establish subsidiaries in the markets, so that the country has been taken back to the situation where it stood before nationalization.

12. Decisions to sell to foreign investors (generally insurance and reinsurance companies in Western Europe), have often met strong opposition from domestic business circles and professional and trade bodies, reluctant to see the positions of national companies weakened by such new competition. Thus, the African Insurance Organization (AIO), at its 15th General Assembly in June 1988, addressed an appeal to "all African Governments to recognize that insurance is a vital tool for economic emancipation and growth and as such its control and basic utilization should be in the hands of the nationals who are totally committed to the development of the country's economy". A widespread feeling at the above Conference was that the necessary assets for building up a genuine domestic industry were given up just when they started bearing fruit. And it was observed privately that liberalizing African insurance markets was "like freeing family pets by abandoning them in the jungle". In this context it has also to be noted that the World Bank itself has expressed strong reservations against privatization of financial institutions. 4/

13. These moves towards privatization on the other hand have been encouraged by the private industry, particularly, but not only, in Latin America. The Declaración de Asunción, passed by the 21st Insurance Conference of the Southern Hemisphere (Asunción, Paraguay, 1987) for example refers to "private insurance" as "a key element in a democratic system, in that it guarantees the protection of persons, property and assets without requiring the high price of loss of liberty".

14. Other markets have been opened to more liberal stances in response to bilateral or multilateral negotiations and pressures. Negotiations between the Republic of Korea and the United States (below) are often cited as an example. According to Mr. R. David Luft, Deputy Assistant Secretary of Commerce, who referred to the "United States insurance industry's potential to expand the sale and service of products globally", the United States Government would be seeking market access for United States insurance companies by eliminating "arbitrary or discriminatory licensing procedures; discrimination against foreign branch operations; forced localization, domestication and government procurement policies discouraging or prohibiting nationals from purchasing insurance from United States companies". Another major goal is to eliminate restrictions on the placement of reinsurance or requirements that reinsurance must be placed with nationalized reinsurance companies irrespective of unfavourable rates.

15. The process of liberalization might also be reinforced as a result of GATT's Uruguay Round of multilateral negotiations under way, which includes insurance, among other financial services. These negotiations may or may not result in fundamental changes in Brazil, India and probably other countries. However, designation of the former two countries as having "unfair trade practices" in the field of insurance under article 301 of the 1988 United States Trade and Competitiveness Act carries the possibility of economic sanctions and will increase pressures for liberalization. Ironically, there are indications that some of GATT's contracting parties would probably have already gone further in the process of liberalization were it not for the fact that this could jeopardize their future ability to get some benefits in exchange. Countries which often seem to believe in unilaterally liberalizing their financial institutions, lose a bargaining chip that might provide a useful tool at the GATT negotiations to increase their access to export markets.

16. There can be no doubt that the GATT's negotiations are a cause of concern for many domestic insurers in protected markets. The possibility that their Governments left the door open to foreign competition in exchange for similar facilities given to their export industries in foreign markets is no consolation for them. A resolution passed by the Third World Insurance Congress in Quito, in June 1988 is an expression of this concern.

17. It must be noted, however, that in certain countries, developments have gone in the reverse direction, i.e. measures have been taken to provide larger room for domestic companies or to admit only foreign companies if they are associated with domestic financial interests. This development has been particularly notable in markets where companies have mushroomed in the absence of any proper government policy.

18. Other structural changes of domestic insurance markets in developing countries have resulted from the expansion or the contraction of the domestic economies. The high income-elasticity of insurance makes insurance sales very sensitive to growth of GDP and sales volumes are in turn a major incentive for the creation of new companies - and the other way round. Stagnating or declining economies, particularly in Africa and Latin America, were reflected in a decrease in the number of companies in some countries, in the same way that expansive economies in a few countries of Asia resulted in a parallel expansion of their insurance markets. The Republic of Korea is a case in point.

19. Dearth of foreign exchange has also resulted in changes of market patterns. Some domestic insurers in Africa ceased writing business because foreign exchange was not available for the payment of reinsurance premiums to their reinsurers overseas. New companies took over as a result, usually with the backing and participation of other foreign reinsurers. The reason given for this participation is a trade-off between access to the capacity and access to the international reinsurance market.

20. Other adjustments were carried out in response to a shrinking of reinsurance capacity. The reasons are clear: at the beginning of this decade, international reinsurance markets were "soft" with the effect that favourable reinsurance rates available to primary insurers in developing areas provided them with comfortable reinsurance commissions at a moment when interest rates were exceptionally high. Since insurers could withhold the payment of reinsurance premiums, their investment income was quite substantial. This "cash-flow underwriting", was popular for many years and favoured the creation of many small insurance companies with low financial and technical backing. However, when international reinsurance capacity shrank, as happened during the period under review, and interest rates started falling, the small companies could not survive and many went out of business. Many markets have experienced important imbalances as a result - particularly in petroleum dominated economies.

21. This situation was largely responsible for uneconomic market structures. Nigeria was a case in point: "The vast majority of companies are non-viable entities. The market is made up of 105 insurance companies, 4 reinsurers, and some 150 insurance broking houses. However, in 1986, the top 25 insurance companies controlled 88 per cent of the market gross premium income". 5/

22. In Trinidad and Tobago, "80 per cent of the business written in the industry was controlled by less than half of the companies, with the rest of the companies struggling to win the other 20 per cent of the business". In Arab countries, "more than 100 companies were formed in the last five years", whereby, "the rapid increase in the number of insurance companies did not reflect any real development ... but merely mirrored the now fading economic boom and the desire to reap investment income" (a report from the region in May 1986).

23. Other market changes affected the countries having granted a refuge for off-shore and "captive" companies (see section (iv) below).

B. Developments at country level

1. Expansion, contraction and other structural changes of insurance markets

24. Brazil: New regulations governing market access include a substantial increase of capital requirements. Higher capital will also be required separately for life and non-life companies and for companies operating in more than one State. The measure is likely to encourage the merger of small companies: at least 37 of the 96 companies are currently below the newly-established limits. It is also expected that the new measures will also encourage the flow of new capital into insurance, with some 30 financial groups said to be interested in entering the market. 6/

25. Mexico: It will now be easier for foreign investors in the assembly industry, the former mostly based in the United States with operational plants located in Mexico near the border, to reconcile Mexican regulation requirements with their traditional covers in the home country. 7/

26. Jordan: The new insurance law (1987) prohibits the registration of new companies but the Council of Ministers is authorized to waive this condition if the total premium income achieved in the Kingdom would amount to at least four times the capitalization of the applicants.

27. Saudi Arabia: For the first time in its history, authorization has been granted for the establishment of a domestic insurance company (Saudi Arabian National Company) in the form of a joint stock company being operated on a co-operative basis and in accordance to Islamic Law. 8/

28. Republic of Korea: During 1988, a significant widening in the number of life insurance companies operating in South Korea is expected. The main spur for these developments is the boom in personal savings from an increasingly affluent population. The combined life and non-life premium income increased by 35 per cent during fiscal 1986, with life business up to a massive 39 per cent and non-life up by 17.6 per cent.

2. Moves towards liberalization

29. Guinea: An Ordonnance of 22 December 1987 has opened the local market and put an end to the monopoly exercised by the State-owned Société Nationale d'Assurances et de Réassurances. All insurance companies are now under the same regulations. The country's Central Bank is responsible for enforcing the new legal regulations and for granting the licences to the applicant companies.

30. Pakistan: The Pakistan National Insurance Reform Commission, set up in December 1987 to study the workings of the insurance industry in the country, has been given the task of considering the progressive de-regulation of life and general insurance and the reshaping of the public insurance corporations in order to bring about structural reforms. Terms of reference also include the identification of areas which need improvement, controls against malpractice in the industry, along with measures to ensure the prompt settlement of claims.

31. Measures on the proposed lines appear to be encouraged by the industry. The Insurance Association of Pakistan is pressing the Government to end the monopoly enjoyed by the public sector. It has also called for the introduction of adequate solvency criteria which would ensure the disappearance of unsound companies. The Association has also requested that the 30 per cent compulsory quota share reinsurance to be effected with Pakistan Insurance Corporation be discontinued. Private companies should be allowed to re-enter the field of life insurance, currently completely dominated by the Government-owned State Life. 9/

32. Gabon: The Government has agreed to pay for the run-off of Société Nationale Gabonaise d'Assurances et de Réassurances and has sold the ongoing interest to the already dominant Union des Assurances de Paris. 10/ A similar course of action is said to take place in other African countries. An African insurance specialist has reported that "a few Francophone African insurance companies are being examined by consultants to determine their financial

status and their future possibilities with a view to foreign equity participation or take-over. One unconfirmed report has it that Socar of Cameroon is being examined by the same consultants who negotiated the Gabonese case".

33. Chad: The setting up in the country of the Préservatrice Foncière Assurances (France) puts an end to the monopoly of the State-owned company.

34. United Republic of Tanzania: In a press interview, the chairman of the Presidential Commission of Enquiry on Financial Institutions said that there was "a question as to whether the existing structure in which different institutions enjoy monopolies of certain types of business should be allowed to continue to do so or whether it would be useful to encourage competition amongst them". The press report 11/ adds that the Commission is advised from time to time by IMF and World Bank specialists.

35. China: An Asian correspondent reports that "The open door policy enunciated several years back continues to be implemented. Joint ventures have been organized with insurance groups in the United States and the United Kingdom."

36. Sri Lanka: The laws implementing the Government's decision to liberalize the insurance market, heretofore in the hands of two State insurers, was passed by Parliament in December 1986 and 1 January 1988. Three companies were registered with the Controller of Insurance; all of them receive management and technical advice from foreign insurance organizations, with whom, allegedly, reinsurance is effected. Although this kind of arrangement is permitted, no foreign capital participation is allowed under the new law. The State companies will continue to do business alongside the newcomers, with their products continuing to carry a State guarantee. Registration of brokers is now allowed but here again no overseas equity participation is allowed.

37. Chile: Legislative changes in 1980 swept away 50 years of protection and fixed tariffs, establishing freedom of prices, an open door to the international market and a minimum capital requirement of just under $US 1 million. "This led to a wave of bankruptcies, mergers and the creation of new companies which has only recently receded. All but a handful of insurers survived the 1983 banking collapse which led to State intervention over some 60 per cent of the Chilean financial system." 12/ But "the Chilean insurance market is now showing steady growth. As a result of the process of adjustment, the market shrank from 115 insurance companies to only 41 today (24 non-life and 17 life insurers)". 13/

38. Uruguay: The Government has rolled back State monopoly by granting private insurers freedom of operation in the country's free trade zones. But the Banco de Seguros del Estado still retains its 75-year-old monopoly on reinsurance and most of the primary market.

39. Republic of Korea: The insurance market, which has been dominated by only six companies for the last 30 years, is now opening its doors not only to the local private sector but to foreign capital as well. Joint ventures with life insurers of the United States have been approved, provided the domestic partner is a company whose consolidated asset valuation ranks it below the 15 largest. It is reported, however, that the foreign penetration of the insurance market is extremely slow.

3. Moves towards domestication

40. Zimbabwe: The new Insurance Act, which was still awaiting promulgation at the time of writing, demands local control of all insurance and reinsurance companies. Fifty-one per cent of shares in a company (excluding brokers and mutural societies) must be held either by Zimbabwean nationals who are "ordinarily" resident in Zimbabwe, or by permanent residents. It is reported that more than half of the locally registered insurance companies will have to make ownership adjustments to conform with the new legislation.

41. Peru: In June 1987 the Executive took steps to nationalize the financial system and to restrict credit, financial and insurance activities to State-owned enterprises. Legal actions undertaken by shareholders of all affected companies have inhibited the implementation of this decision. At the time of writing, insurance companies continue to be controlled and managed by their former owners.

42. Bahrain: A legislative decree passed in 1987 called for the "Bahrainization" of foreign-owned insurance companies. A total of 30 companies would have to modify their legal status in that at least 51 per cent of their equity must be in Bahraini hands.

43. Oman: Compulsory reinsurance with national companies to which foreign insurance companies are obliged was increased from 15 to 30 per cent. Local companies were granted priority in getting the business of statal and para-statal organizations, provided their rates are less than 10 per cent above those quoted by foreign companies.

44. United Arab Emirates: Locally incorporated insurance companies in the UAE in which minority shares were held by foreign partners have been reminded that all of their shareholdings must be localized by 30 June 1988. Insurance companies registered in the UAE shall be fully owned by nationals. 14/ In addition, as a result of new paid-up capital requirements, the number of locally registered insurers has fallen from 76 to 56. 15/

45. Kenya: The Insurance Act of 1984, which came into force in 1987, is said to "act as a deterrent to fly-by-night" companies and provides for the selling by all foreign-owned companies of at least one third of their shares to Kenyan nationals. The appointment of managers and other executives must first get the approval of the Commissioner of Insurance.

4. Offshore and captives

46. Barbados: The captive market has continued to grow, a development that is said to be particularly linked to the double taxation treaty with the United States concluded in February 1986. The treaty gives total exemption from the United States Federal Excise taxes on offshore insurance and reinsurance premiums. Seventy-two captives were licensed and the Finance Minister said he expected more than 100 to have commenced operations soon. Government officials have visited Japan and the Federal Republic of Germany to explore the possibility of double taxation treaties to boost the island's attraction to captive owners, and attempts have been made to conclude a similar treaty with Sweden. 16/

47. Singapore: The Insurance Commissioner has expressed the wish to develop the country into an important insurance centre; offshore reinsurance business and captive insurance have been targeted as the most important areas for growth.

48. Malta: The Malta International Business Activities Act of 2 November 1988 exempts offshore enterprises from certain requirements imposed on domestic companies. These requirements affect mainly taxes, minimum paid-up capital and solvency reserves. It is expected that as a result Malta will become a major offshore and financial services centre during the next decade.

49. Mauritius: Press reports indicate that the Government is "seriously eyeing the possibility of developing Mauritius as a financial centre; officials recently visited the Bahamas and Bermuda to pick up ideas for offshore banking and other financial services. There is to be a Controller of Insurance, who will control registration and supervision and hear complaints ...". 17/

Chapter II

OBSTACLES TO THE EXPANSION OF DOMESTIC INSURANCE COMPANIES AND OPERATIONS

50. The period under review has seen an aggravation of the obstacles to the expansion and the strengthening of domestic markets. This has resulted in several insurance companies becoming under-capitalized and under-reserved and has caused a considerable problem regarding their ability to perform properly the necessary functions. In one Latin American country, for example, "most if not all the companies which write motor business would be technically bankrupt if this loss were included in their annual accounts". 18/ This would be an exceptional example which by no means reflects a general situation, but other countries are not too far from the same kind of hardships. In a North African country, domestic insurers "are estimated to be under-reserved to the tune of ... $US 250 million, a figure that overseas observers multiply by two and which is still rising". In a South-East Asian country, reports speak about "fraudulent practices, inadequate capitalization, slow premium collection and payments, premium and commission kick-backs and incestuous investment practices ... The market is in a mess. Record-keeping is often abysmal and in some companies the trading accounts bear little relation to the underlying financial position of the firms. At least eight companies are under investigation as a result of recent complaints about abuses and mismanagement. A conclusion can be drawn up, therefore, that solvency has deteriorated in many markets."

51. In several countries, insolvency of insurance institutions, fragility of markets or their instability have been identified as the basic problems of the particular period under review. They are clearly related to one or more of the following factors:

(a) An adverse macro-economic environment;

(b) Specific technical factors, such as rates ceilings which are inadequate in view of claims in automobile insurance, excessive awards in courts, and the problems experienced by the marine insurance market in many countries;

(c) Poor management, unsatisfactory regulation and supervision, and questionable business practices;

(d) A low risk-bearing potential, aggravated by important catastrophe-prone conditions;

(e) The external environment, particularly the international reinsurance markets and their operations.

A. The macro-economic environment

52. Prevailing economic conditions in many developing countries have resulted in a general decline in business activity in most sectors of the economy. In insurance, the decrease affected most classes of business, especially the motor, fire and marine business. Particularly affected have been countries of the Middle East hit by the slowdown of the economies of the oil States and the influence of the Gulf War.

53. Adverse economic conditions have also resulted in a dearth of foreign exchange and in monetary problems leading to currency devaluations. This has disrupted in many ways the normal business relations between domestic insurers and their foreign reinsurers. Difficulties in this respect have also prevented stronger co-operation among developing countries and an increase of their regional capacity.

54. The following lines on the situation in the United Republic of Tanzania illustrate a situation which is common to many countries, particularly in Africa:

> "Particularly worrying are the arrears owed to (international reinsurers), currently running at ... $US 5 million. With more pressing demands (such as fuel imports) to consider, the Bank of Tanzania is reluctant to allocate foreign exchange to the National Insurance Corporation and arrears have been building since the early 1980s. Monthly devaluations under the current IMF programme increase the burden. The lack of foreign exchange has caused other problems for insurers. Imports of cars and other goods likely to be insured fell at the beginning of the decade, coinciding with a decline in new building, depressing the demand for fire and property insurance." 19/

55. Obstacles to the free and swift remittance of premiums to overseas reinsurers make negotiations with them even more difficult and erode the bargaining power of the reinsurance buyer. The situation encourages also the direct purchase of insurance abroad: foreign exchange for the payment of premium is often more readily available to the local insured party (e.g. a shipping line) than to the insurer. There is some irony in a situation in which dearth of foreign exchange prevents national insurers from underwriting local business and induces the insurance buyers to seek cover abroad, involving foreign exchange expenditure higher than before.

56. But scarcity of foreign exchange has in certain instances also had a positive effect. As one correspondent points out with reference to Africa, difficulties in that respect have "compelled the African insurance markets to become more innovative and to devise self-sustaining policies and programmes aimed at ensuring their survival". For example, the concept of pooling, regional co-operation and programmes aimed at increasing market retention capacities at subregional and regional levels are being seriously promoted [see chapter III]. The policy of self-survival created by the adverse economic situation has had the effect of making the African insurance markets become inward-looking and more determined to address the many serious problems facing the industry in these markets. Thus, in most African insurance markets there is a general commitment to the development of a dynamic, financially viable insurance industry which can be relied upon to meet its obligations to the insured community.

57. Nevertheless, it has by and large been accepted that foreign exchange problems, leading to exchange controls, delays in payments or lack of convertibility, have been, as Eyessus Zafu (African Reinsurance Corporation) pointed out, "the most critical stumbling block" to regional co-operation among developing countries.

58. The deterioration of general economic conditions has manifested itself in certain countries by acute hyper-inflation, which has been particularly disruptive for a monetary-based business like insurance. In Argentina, where the monthly consumer price index went up by 33 and 79 per cent in April and May 1989, the phenomenon has "brought chaos to the insurance industry and in particular the motor account". 20/ Motor covers are now expressed in "Insurance Account Units", an automatic daily adjustment device which follows the development of the wholesale price index of 60 days earlier. But "many policyholders are now unable to pay their premiums which are also IAU-linked. Many vehicle owners are downgrading their policies from comprehensive to third-party/total loss, while others are simply cancelling altogether, causing an unanticipated and very untimely slump in insurers' cash flow" (see above). Although, the magnitude of the Argentinian inflation problems was unparalleled, not many developing countries have been free of turbulences due to inflation.

59. Investments, which play a paramount role in the insurance business, are another field where prevailing economic conditions have inflicted damage. A Caribbean country reports that insurers' investments in mortgages have been threatened by retrenchment, receiverships and a general reduction in incomes of mortgagors. As a result, insurers had to embark on steps to reschedule mortgage payments, waive or reduce penalty charges and even sell properties.

60. Even in the absence of difficulties of this kind, the obligation to invest in local assets stipulated by insurance legislations in many countries is increasingly considered as an indirect and heavy taxation by the insurance industry: given the present investment climate of the West African States, for example, the question is indeed justified as to "what kind of investments are available for the insurance industry, especially the type of investment which can readily turn to cash to settle losses". 21/ It must be realized that when too much is expected or demanded from the domestic industry - that for instance investments are to be made in government securities which have low rates of interests, or that insurance rates are to be held down in order not to aggravate the price indexes, or that payments due to reinsurers have to be delayed to hold on to foreign currency reserves, to name only a few factors - the market is subjected to such poor operational conditions that it can only supply unsatisfactory services, for which the national economies and the insured community bear the cost. In this case, there might emerge a temptation to go back to the former situation where the market was in the hands of foreign companies which enjoyed almost unrestricted freedom of action and were able to deliver better services.

B. Technical factors

61. Motor, marine and some other branches have traditionally been difficult branches in many developing areas. In some of them, underwriting these classes of business has been more difficult than ever.

62. Motor insurance is perhaps the most conspicuous example. Firstly, the accident rate has increased in recent years. Martin Bailey speaks of roads as the biggest killer in the Third World. 22/ He points out that "more than a quarter of a million people are killed every year in road accidents. Of those who die between the ages of 5 and 44, 10 per cent are killed in accidents, a

higher proportion than from any disease listed in WHO statistics. Accidents on the roads are costing the developing countries more than £16 billion a year. More Third World States suffer a greater financial loss from these accidents than they receive in foreign aid. Africa tops the accidents list ... Vehicles are poorly maintained. A study showed that in Delhi nine out of 10 buses had rear lights, brake lights or side lights out of order. Vehicles are dangerously overloaded, with workers packed into the back of open lorries and passengers hanging on the outside of buses. Nigeria, at the top of the league, has 234 people killed in a year for every 10,000 vehicles on the roads, compared to three fatalities per 10,000 vehicles in Britain".

63. Colombia, where it is calculated that as many as 3,000 people are killed and some 25,000 are injured each year in road accidents, provides an example of conditions present in many developing countries: 1. Rugged, mountainous terrain of many zones; 2. Precarious condition of rural highways; 3. Motorists able to secure driving licences without undertaking rigorous tests; 4. High incidence of drunken driving; 5. Questionable mechanical state of many long-distance buses and trucks which receive little, if any, regular maintenance. 23/

64. In spite of strong measures adopted by a few countries (e.g. Senegal), growing accident rates and the absence of a corresponding rise in tariffs have considerably worsened underwriting accounts. Claims ratios (claims paid and due in relation to premium income) of more than 200 per cent are not unusual. Insurers often complain of antiquated tariffs, which are artificially held down by Governments in order to contain inflationary pressures. Governments on their side often complain of the inability of insurance companies to manage their business better, to compress overheads and accuse them of demonstrating an excessive degree of greed).

65. As one broker put it "companies had reserved for 85-95 per cent loss ratios, but are closing old years at 250 per cent". 24/ In Egypt the loss ratio before expenses was 115 per cent and, for compulsory covers, it approached 300 per cent. It is not only the frequency of accidents that has taken its toll. In Malaysia, "There is massive claims fraud 'assisted' by repair workshops, doctors and even insurance company staffs". 25/ Not only are tariffs inadequate, but claims management is also at fault. In Morocco the situation has been exacerbated by delays of up to 15 years in concluding litigation. High court awards, following court decisions which parallel policies being followed in developed countries from where judicial codes and philosophy derive, are commonplace in some countries.

66. In a few cases the situation is aggravated by unpopular award policies with companies indemnifying exhorbitantly high sums which seem out of proportion to the particular social and economic environment to some selected people on kinship or allegiance basis, while providing poor claims servicing to the general population. This has resulted in a widespread deterioration of the insurance image and encouraged fraud, which in turn is leading to an increase in tariffs.

67. Marine cargo insurance has also given rise to concern. The problem here is usually not unprofitable underwriting, but a deterioration of the role that insurance is expected to play in the economy. This is mostly felt in

developing countries where Governments have compelled importers to insure transportation risks locally and which have seen the provisions circumvented for all practical purposes through dubious business practices which increase the cost of imported goods. "Poor communications have in the past led to much double insurance, with exporters considering the local coverage as a tax. The minimum coverage is purchased from the local insurer, frequently at the port of arrival (to comply with local legal provisions); the real insurance has been contracted with the exporter's own insurer on full conditions. This explains in part the excellent results of Francophone African cargo insurers, who charge high rates and issue policies to insureds who will never, because of double insurance, bother to claim. To overcome the communication problems, the Paris-based organization ... has set up a world-wide network of certificate issuing services to allow exporters to obtain full documentation, on paper of the importing country's insurer, prior to dispatch. The cost of the insurance is paid by the exporter, who recovers it from the importer." 26/

68. Double insurance and its corresponding economic costs does not only affect marine business; "difference in conditions" policies are usually purchased by multinationals, which buy for example, "total loss only cover" from a local African company and the much more expensive "all risks cover" from elsewhere - usually from captives when local legislations require them to buy such insurances locally.

69. Arson and maritime fraud are also on the increase and have affected underwriting results to an unprecedented degree. In Nigeria, "arson now costs well over N100 million a year and causes over a hundred deaths ... Fraud has been the major cause of arson, both in the private and public sector of the economy". 27/ Marine business is particularly affected. "At a recent Interpol meeting in Nepal, maritime fraud was scored as a major problem. Scams plague several areas in the region; Indonesia, China and Hong Kong were mentioned as being most affected. Apparently, the fraudulent con operations involve ships registered in an international registry, flying flags of convenience which are then chartered to carry a valuable and (hopefully) easily disposed of cargo. Somewhere the ship is unloaded and in time the ship is reported 'lost'. Lost in this case means being registered under a different name. The vessel then appears in another port under its new name and presumably the operation is repeated." 28/

70. Other sources of fraud relate to the use of containers and involve inter alia documentary fraud (forged original bills of lading, fictitious invoices, forged certificates of origin), over-stated claims by surveyors and racketeering on insurance certificates (very old, poorly maintained vessels with very high insurance values). 29/

71. Meanwhile, life insurance has found its worst enemy in AIDS, particularly in some African countries, where the most affected social category is often the one more likely to buy life policies.

C. Other Deficiencies

72. The slow pace in premium collection is a traditional difficulty in developing countries which has reached new heights in the period under

review. At a recent general assembly of the FANAF ("Fédération des Sociétés d'Assurance de Droit National Africaines") it was pointed out that "the amount of unpaid premiums is reaching intolerable levels: 70 per cent in some companies". Obviously, liquidity and solvency problems follow.

73. A problematic development in some African markets has been the appointment of general managers of State insurers, who tend to be the former insurance controllers or other Government officers who are not necessarily the best qualified for the post. A lingering esprit de corps within the insurance industry has in some cases resulted in a deterioration of services and in the absence of serious managerial efforts. Obviously, the problem is linked to the absence or shortage of insurance education facilities and possibilities of improving professional qualifications in many countries, an issue which is surely one of the most critical challenges facing the advancement of domestic insurance industries in developing countries.

74. Inadequate supervisory systems are becoming a major obstacle to the soundness of the insurance markets. Although the World Bank has asserted that there is a growing recognition that effective prudential regulation and supervision are essential (to the process of liberalization of financial institutions), 30/ there has not apparently been an adequate effort towards improving the supervisory systems, a necessary condition for the process of liberalization. Some difficulties stemming from the inability of domestic insurers to collect indemnities from their overseas reinsurers certainly result from shortcomings in the field of supervision and the lack of appropriate regulatory measures.

D. Low level of insurance capacity

75. The risk-bearing potential of the insurance industry has probably decreased during the period under review. Insurance capacity is largely based on a sound spread of the risks included in the portfolios of each of the companies participating in the market. The presence in the market of many small companies with a small premium income, coupled with an unprecedented accumulation of insured values and the threat of claims of catastrophic proportions, are determinant factors for the low risk bearing capacity of many markets.

76. Low premium income of domestic markets stems in part from the volume of insurances which buyers in developing countries take out in international markets. In Africa, "major European companies operate under different types of arrangements which tend to increase the amount of premiums ceded outside Africa. In some, they operate post-office like branches while in others they run outright agencies and in both cases the bulk of premiums written are transferred to the parent companies", (Eyessu Zafu, addressing the African Insurance Organization in Brazzaville). In the Middle East, the boom years and the extensive construction work which they brought to the oil-rich States are long gone, and the consequent slump in demand for construction and fire covers continues. Slow or non-existent economic growth resulting in a shrunk premium income for many companies is inevitably reflected in the risk-bearing capacity, which diminishes more than proportionally. This means that each of the companies in the market has to rely more on reinsurance which poses its own problems.

77. Catastrophes have taken a heavy toll on insurers in developing countries. Even if they do not materialize, the threat of catastrophes greatly limits insurance capacity. During the period under review, catastrophes did materialize in very considerable proportions. The century's worst hurricane - Gilbert - followed by tropical storm Joan, swept over Mexico and some countries of the Caribbean, causing in Mexico alone material damage estimated at around $US 600-800 million. According to official news more than 100 people perished, some of them belonging to a co-operative of fishermen, insured by a local company. In El Salvador an earthquake devastated the country's capital of San Salvador in October 1986, causing losses amounting to $US 1 billion, or one fourth of the GNP in 1986; 1,500 people died, 10,000 were injured, 300,000 homeless. The 11 domestic insurers were only concerned with 15 per cent of the losses, and most of them were reinsured overseas. While these are only a few typical examples of the vast potential of destruction to which the developing world is very prone, they tend to demonstrate that thorough outward reinsurance planning is a primordial condition for the survival of the insurance industry.

E. External environment

78. Heavy reliance on international reinsurance markets has fortunately helped overcome a number of difficulties of developing countries in the field of insurance. The insurance industry in many of these countries can survive only thanks to the sharing of risks and the transfer of technology that reinsurance markets around the world provided. This dependence has, however, also caused problems.

79. First of all, there has been a widespread problem of solvency of some international reinsurance companies - a systemic risk with potentially devastating effects particularly for insurers in developing countries. 31/ If large reinsurance claims are not paid, as has in fact happened, a domino effect is likely to result which disrupts the whole insurance system. The Asian Insurance Council's Chairman illustrated the point when he drew attention (in a speech to a financial surveillance and security assessment seminar in Singapore on 27 January 1986) to the fact that many insurers in the region were concerned about technical insolvencies and deficiencies among United States reinsurers and insurers and were wary about becoming involved in the "United States experience". He said that 12 United States reinsurers had gone bankrupt within the previous year, three major United States commercial line insurers had come close to insolvency, and many others might be technically insolvent and required to liquidate due to insufficient surplus to cover unpaid claims. Turning to Singapore insurers specifically, he said most were far from insolvency because the regulatory authority kept a close watch on their financial soundness. But they should still acquire more skills and resources to read danger signals in their own and their overseas reinsurers' accounts and balance sheets.

80. Other problems relating to foreign reinsurance concern the so-called "reciprocity" business - reinsurance operations from international centres in which insurers can participate as a reward for the business they themselves cede to these centres. In general, reciprocity, which was meant to offset reinsurance costs with reinsurance profits from inward business, has resulted in heavy losses. In particular, the quality of the risks being transacted

appears to have been in many cases of the lowest quality, being those that insurers and reinsurers wanted to get rid of. "Korea Re's top management learned from this experience and has drastically cut back the volumes now accepted from abroad. All long-tail and questionable business has now been cancelled (some at the cost of continuing litigation and complex run-offs involving the reinsurer). Now that local insurers and the Government understand the business better, the requirement to balance inward and outward fund flows absolutely has been dropped and the emphasis is on strict underwriting standards and business quality. Building catastrophe reserves and developing risk control are now priorities." 32/ A sound assessment of this nature tends to gain ground in an increasing number of developing countries.

Chapter III

MEASURES AIMED AT THE STRENGTHENING OF DOMESTIC MARKETS

A. General considerations

81. While adverse conditions of the kind described above affected many countries (not only developing ones), and by and large inhibited the expansion of domestic insurance markets, they did not affect all developing countries. In fact, many of them fared rather well. Even where circumstances were negative, the insurance industry was sometimes successful in weathering the difficulties fairly well. There are many examples where courageous and enterprising efforts were crowned by encouraging success.

82. At the companies' level, efforts have been pursued to make the administration of these companies more efficient. Many of them have begun or continued a process of computerization of their operations. Insurance operations generate a tremendous amount of data and the industry will only be able to move forward satisfactorily if new technology is applied to information gathering, storage and retrieval. A local correspondent indicates that the India insurance industry has launched a massive computerization programme to handle the voluminous task of issuing 18 million documents and settling 1.5 million claims annually. This process has also been successfully introduced in some State insurance supervisory offices. Thus, Trinidad and Tobago's National Insurance Board is reported to pursue a programme in that direction.

83. On a policy level, regional insurance associations have in several instances put forward new suggestions for the expansion and strengthening of the insurance sector. An example is the list of propositions put forward by the 14th African Insurance Organization Conference at Brazzaville (June 1987) which calls for:

- Consolidation of existing companies (especially reinsurers) before creation of new ones;

- International reinsurers to host a meeting of finance ministers to discuss settlement/exchange problems;

- African companies to recommend that their brokers place 25 per cent of outward reinsurance with African reinsurers;

- Companies to provide more statistics to back up African reinsurers; and

- Encouragement to the development of African intermediaries.

84. The concern underlying these and similar recommendations is not only that present difficulties call for new approaches and a serious effort of adaptation of the domestic markets, but also that risk-bearing potential of developing countries and regions must be encouraged and improved.

85. The following paragraphs illustrate positive development signs in selected areas:

1. New covers of particular interest

86. The last two years have seen the emergence of several insurance programmes that, beyond their commercial and profit-making interest for the underwriting companies and their usefulness for the insured community, had particular stimulating effects on the economies as a whole. One of these programmes concerns agricultural insurance. Its importance was highlighted at the World Insurance Congress (Quito, June 1988), where one of the resolutions adopted asked for the setting up of insurance companies specialized in that line of business in each of the countries concerned. Indeed, many of them are interested.

87. However, available information also shows that actual projects in this field have been rather scarce, and that some insurance programmes that were introduced have been totally or partially discontinued, due to the fact that this cover is one of the most difficult ones to operate, particularly in developing countries. 33/ As the Indian example below suggests, crop insurance may give rise to a considerable "moral hazard" or even fraud, and even without these it generally takes sizable contributions from the Governments' budgets. Another example comes from Thailand, where Thai Reinsurance Corporation has indicated that it is no longer prepared to support the Government crop insurance scheme after nine years of increasing losses (cotton was the most hazardous risk because of drought and insects).

88. However, the possibility of setting up crop insurance programmes is given continued consideration in many countries, due to the potential benefits of rural covers on investment and output. Along with the traditional argument that crop insurance facilitates borrowing from credit institutions which enhances investments and crop outputs, it is also felt that crop insurance could help integrate into the stream of financial resources the sterilized assets (gold, etc.) that farmers are now hoarding in the expectation of crop failures that will inevitably hit them one day or another. At present, the benefits arising from these assets being made available to the domestic economy are generally not taken into consideration in the cost/benefit analysis of crop insurance projects and thus the overall advantages of this insurance for the national economies are often underestimated. As a crop insurer said privately recently, more onerous for the Government's budget than a crop insurance scheme would be the absence of a crop insurance scheme.

2. Other measures aimed at the strengthening of domestic markets: Insurance education; loss prevention

89. A correspondent writes from South-East Asia that "In the field of insurance education, intensive programmes have been organized in a number of developing countries. Awareness is growing among developing countries that professionalism not only among key personnel of insurance companies but also of insurance intermediaries, brokers and agents [and we would add, that of the supervisory agencies] is most necessary for the growth and development of the industry".

90. The importance of insurance education has also been highlighted by the 15th African Insurance Conference (Harare, June 1988) which recommended that "In view of the present shortage of highly trained and experienced personnel in the African insurance business, concerted action should be taken

by the industry to promote training and manpower development at company, national, subregional and continental levels and should be reflected in the annual budgets of all insurance companies and institutions". 34/ Developments in China and Thailand, which are looking to set up training centres; Indonesia, where an actuarial education programme has been developed; Malaysia, where the University of Malaysia offers courses in insurance and risk management conducted jointly with the Malaysian Insurance Institute, together with an Insurance Executive Development annual programme and a three-month intensive course on Industrial risk management; Hong Kong, which offers a course for a professional diploma in business studies in insurance; Malta, where the Mediterranean Insurance Training Centre offers a two-week intensive theoretical and practical course in reinsurance; Zambia, where an Insurance Business College is now well established, including reinsurance in its intermediate insurance course with plans to extend the syllabus much further; Zimbabwe, where the Association of East African Insurers is proposing to set up a college for insurance ..., all these and more are encouraging signs that the message has been heard.

91. Meanwhile, it is also reported that despite the recognition of the need for training, several existing insurance institutions have not been given the amount of support and financial means they needed. Decreasing contributions from the industry and other funding sources - often stemming from decreasing premium incomes and less optimism about the growth of the industry resulting in cutbacks in training budgets - affected the normal course of activities, or even threatened the very existence of these educational centres. Most talked about among the present difficulties concerns the International Insurance Training Centre in Yaoundé, Cameroon, which was set up in 1974 by the Governments of French-speaking Africa and which is said to have gone through a difficult financial period.

3. Self-regulatory measures, loss prevention, and other measures

92. Several countries, particularly in South-East Asia, have started experimenting with self-regulation through inter-company agreements. (In some instances, it would be difficult to draw a borderline between these kinds of agreements and a cartel or another means to restrict competition). In some of these and other countries, the Governments have also urged the insurers to police themselves. Thus, in Trinidad and Tobago, the Finance Minister asked the companies to consider the establishment of an independent mechanism for the determination of fair rates in property as well as motor insurance. In Hong Kong, the first draft of a code of practice has been laid down. Based on the principle of self-regulation, the code covers areas of public concern not embraced by the Insurance Companies Ordinance. In Malaysia, as a step towards reducing malpractices in motor insurance, the insurance industry has adopted self-regulatory measures on a collective basis through an inter-company agreement on motor norms, with the objective of having uniform practices on motor underwriting and claims procedure, including control of commissions, appointment of agents, etc. Negotiations to establish a National Loss Prevention Association with the co-operation of the police, the fire department and other authorities are also being undertaken by the industry.

93. In Singapore, a Motor Insurance Bureau has been organized by the industry to make compassionate payments to persons injured and dependants of persons killed in motor vehicle accidents, for which the negligent driver could not be traced or where no valid insurance policies exist. In the same country, the

Insurance Ombudsman was set up in August 1987 by the General Insurance Association of Singapore to provide an independent and objective assessment of cases of disputes on policyholders' claims arising from personal general insurance policies. The Ombudsman Committee is made up of eight members, including a representative from the Insurance Commissioner's Department, the Consumer's Association of Singapore, the legal and accounting profession and two from the insurance industry. The Committee may award damages up to $US 50,000. Its decisions are binding on the insurers but not on the policyholders-claimants who may reject the awards and pursue their claims in court.

B. Some country developments

1. New measures aimed at the expansion and diversification of the markets and the improvement of their insurance services

(a) Agricultural insurance

94. Nigeria: A national agricultural insurance agency has been set up for livestock. The scheme will be open to all private poultry and livestock farmers in the country. The operator will also entertain requests to provide cover for government-backed agricultural ventures. On the other hand, efforts to work out a full-fledged agricultural insurance scheme have failed. Officials have been citing the huge financial commitments that will be required and the lack of statistical data.

95. United Republic of Tanzania: The National Insurance Company is now considering crop insurance, "an essential step if agriculture is to be successfully opened up to the private sector, as the Government intends". 35/ However, a major difficulty is that catastrophic crop failure could wipe out the national insurer's reserves and require a massive government subsidy.

96. India: The Central Government has decided to introduce a countrywide comprehensive scheme of crop insurance, to be operated through the General Insurance Corporation of India with the active involvement of the State Governments. The main objective has been to stimulate the production of cereals, pulses and oilseeds through financial support in case of agricultural calamities. Half of the premium charges were to be subsidized by the State and Central Government in the case of small and marginal farmers. However, the Central Government has had to face huge liabilities arising from severe drought over the past three years, which were considered beyond its budgetary resources. The scheme has been suspended for some time and will now operate on a modified basis and with a strict limitation of indemnities per claim for wheat, rice, millet, oilseed and pulses.

97. Pakistan: The Government has decided to introduce crop insurance, beginning with wheat and rice. The main purpose is to help farmers to reimburse their loans from the Agricultural Development Bank in years with low yields. It is reported in this respect that one year in every five is sure to be of low yield, making it impossible for farmers to repay their bank loans, which are eventually written off. A major reinsurance company of Western Europe has helped prepare a draft of the programme.

98. Philippines: The Philippines Crop Insurance Corporation has launched a new livestock insurance programme.

(b) Other categories of business

99. Egypt is to establish the Export Guarantee Company of Egypt, shareholders of which will be the National Investment Bank, the Export Development Bank and some domestic insurers.

100. India: The Export Credit Guarantee Corporation of India, which provides cover for exchange fluctuations to Indian exporters, has expanded its scheme which includes now payments for import of raw materials or components and advance payments received from a foreign party on certain conditions. Cover for exchange fluctuation risks will be available only if the payment for import is designated in one of seven major currencies. Certain limits apply.

101. Pakistan: A compulsory insurance scheme for export goods is to be introduced by the Government. It would provide cover even for exports to war-torn or politically unstable countries (which most Pakistani insurers will no longer offer) and guarantee instant payment of claims under an automatic disbursement provision.

102. Mexico: The supervisory authorities have modified the rules for earthquake cover as a consequence of the serious losses arising out of the September 1985 earthquake. Basic rates have been raised; agent's commission has been reduced from 18 to 7.5 per cent regardless of the size of the premium; the difference of 10.5 per cent will be transferred to the catastrophe reserve. The latter will now be constituted as follows: 60 per cent of the net (retained) premiums; 10.5 per cent of gross (direct) premiums; and a proportion of the investment income from the reserve. Also, on the same issue of catastrophe covers, one leading company has given up the traditional practice of arranging outward reinsurance protection via proportional fire treaties in favour of retaining all earthquake risks in its own account, protected by an "excess-of-loss" reinsurance programme arranged in a major international reinsurance centre. Other Latin American companies are interested in this new approach, which would increase availability of catastrophe covers to the general public and make it more manageable for the insurance companies.

103. Nigeria: In May 1987, a Seminar on Road Traffic Accidents in Nigeria, organized by the International College of Surgeons, Nigeria Branch, pointed out that more human lives were lost on roads than in hospital sick beds and put forward a number of suggestions.

104. Senegal: Improvements with respect to motor insurance are taking place: laws have been passed which require inspection of vehicles more than three years old, the speed limits have been decreased and an obligatory seat-belt law is being implemented. Other features include systematization of obligatory insurance, uniformity of awards, categorization of garages and control of repair prices, and periodic meetings of magistrates, judges, physicians, insurers, fleet owners and other involved parties.

105. Kenya: The Kenya Motor Insurance Pool (an important tool of the market for absorption of the loss-making motor business) has been reactivated after a suspension because of adverse loss experience. In addition, insurers have been involved in insuring the national airline Kenya Airways.

106. Zimbabwe: Some progress has been made in solving the problem of war risk insurance for traffic passing along the railway line to the Mozambican port of Beira. However, key risks remain uninsured and negotiations with insurers both on the domestic and foreign markets continue. In addition, the local insurance market has set up a Special Risks Insurance Consortium, comprising 12 direct insurers, three reinsurers and the Zimbabwe Reinsurance Corporation, with the objective to cover locally vehicles on the Tete run in Mozambique. While insurance on such risks was available abroad, the local market could not provide sufficient cover. Other risks are also considered (International Research Services, February 1988). However, reports are that the Consortium was in a difficult position just after its creation as a result of a single claim after a rebel attack on railway equipment.

107. India: Plans to offer cover against acts of terrorism are now being drafted. Also, the idea of having an India marine protection and indemnity Club is still under study. Another project under consideration is the introduction of a cover for corporate, professional and public liability risks arising in India.

108. Thailand: A decision by the Mercantile Marine Promotion Commission encourages government agencies and State enterprises to use only domestic marine insurance services for imports funded by the World Bank. The Commission's intervention comes after an announcement by the World Bank that its clients would be permitted to make a choice of the companies providing domestic transportation and marine insurance services for imported goods bought using World Bank loans. 36/

109. Middle East: Directors of 32 Arab-owned insurance companies operating in Gulf States have met in a bid to set up a competitive alternative to war risk premium rates charged by international underwriters.

110. Thailand: A joint committee from the Insurance Department and the General Insurance Association of Thailand was convened to find out possible measures to promote the underwriting of marine cargo insurance locally. Three proposals were submitted to the Government for consideration, i.e: (i) to require firms which have been granted promotional privileges from the Board of Investments to place their marine insurance needs for imported machineries, components and raw materials with local companies; (ii) to require firms of public enterprises to insure their imports or exports with local companies; (iii) as an incentive, to allow importers and exporters to claim a double deduction on marine insurance premiums as deductible expenses. Reports have been received that the two first proposals have been approved in principle by the Cabinet, while the third is subject to further studies.

C. Developments regarding life and health insurance

111. Middle East: Insurance and reinsurance companies are moving towards introducing a total ban on insuring the lives of people carrying the AIDS virus or suffering from the fully developed syndrome. In the case of very large covers, clients may be required to undergo an AIDS test. 37/

112. Ghana: The Government has proposed the institution of a health insurance scheme to cover all workers, including farmers, fishermen and their dependants. The rates are said to be such that all categories of workers can afford some coverage.

113. Argentina: Press reports announce that the authorization for the first time in Argentina of private pension schemes could produce a boom in the domestic insurance markets. Reliable market estimates put the number of insured at up to 1 million within 5 to 10 years. The only snag is that Argentina's high inflation rates in recent decades have made long-term commitments of any sort unpopular. Market sources anticipate, however, that when pension schemes become a normal part of salary packages this antipathy will begin to fade. Also, under a new system of personal insurance, a package including life, retirement and accident benefits will be offered to the public. Under the layered combined-policy scheme, premium will be converted into units of account which will "belong" to the insured (life policy holders' funds in a mutual) and could be withdrawn at any time.

114. Mexico: The first mortality table for group insurance has been worked out. It apparently shows substantial differences compared with the one now in use, based on individual risk for the years 1962-67; the differences will likely result in lower premiums which in turn will enable insurers to make a deeper penetration of the market. 38/ (International Research, September 1987).

115. Hong Kong: Life insurance companies are increasingly marketing "universal" and "unit-linked" life policies (contracts of insurance on life or contracts to pay annuities on life where the benefits are wholly or partly determined by reference to the value of, or the income from, property of any description of any bank).

116. Pakistan: The House Building Finance Corporation and State Life Insurance Corporation have signed a contract under which loans of HBFC will be automatically insured with SLIC. The scheme will be compulsory for all eligible for the purchase or construction of a house for residential purposes. In case of death of the borrower, the outstanding loan amount will be paid by State Life.

Chapter IV

NEW REGULATIONS ON SOLVENCY, ADMINISTRATION, CONTRACTS

A. General considerations

117. As suggested in chapter II, the insurance industry has been a victim of the depressed economic times that many developing countries have gone through during the period under review. Indeed, the general economic situation has been a major factor in the failure of several insurance companies (among other financial institutions), not only in the more severely affected countries. Also, as an Asian correspondent pointed out, unhealthy and unsound competition and business practices have made a comeback. Moves towards liberalization (chapter I) have surely increased these developments. For all these reasons, the need has been felt for a strong State supervisory system to take up the monitoring of the financial and managerial integrity and capacity of the insurance industry.

118. In fact, an increasing number of countries have come to realize that insurance can only grow and develop within the framework of effective legislation and a dynamic regulatory body, aimed at instilling discipline and cultivating business morality among insurers, professionalizing the business and developing insurance consciousness among the people. This philosophy has resulted in a number of countries putting more emphasis on prudential regulation and supervision, at the expense perhaps of product and price controls. More particularly, it has promoted the strengthening of insurance supervisory departments in some developing countries.

119. In line with the above, a correspondent in Africa points out that in Morocco, attention is being focused on the financial viability of insurance companies and the adequacy of their reserves. In Nigeria, according to statements made by the Minister of Finance, similar action is being taken where the new insurance legislation is expected to address the problem of financial viability of insurers and reinsurers with a view to their being strengthened. In addition to the objective to provide room for increased retention capacity, a committee which investigated the reinsurance activities of insurance companies has put forward a series of recommendations which shed some light on the solvency problems that inward reinsurance business brings about for domestic insurers.

120. More generally, insurance supervisory departments in the ASEAN countries have collectively set up an Early Warning System (EWS), patterned after the model set up by the National Association of Insurance Commissioners in the United States. The EWS comprises a set of financial ratio tests with which to detect those insurers likely to face financial difficulties. The EWS incorporates a point system to rank and prioritize the insurers for the purpose of review and inspections. The Philippines, Singapore and Thailand have already successfully adopted the system, with some variations being made to the model formula and ratios to suit local conditions. But these are regional and partial efforts of limited scope, while it is felt that more comprehensive approaches are needed. The attention of insurance regulators should be attracted in this respect by what is being worked out, under the aegis of the Bank for International Settlements, in the field of financial institutions in general, aimed at regulating their risk exposure, including

the evaluation of capital requirements, based on risk weights for different types of assets. A project of that scope, applicable to the specific insurance sector, would probably be welcomed by many Governments and insurance departments in developing countries and help them perform their important tasks.

121. Meanwhile, the problems of undercapitalization and the need for action have also been taken up collectively at the 15th African Insurance Conference (Harare, June 1988). The Conference requested the African Governments through their regulatory bodies and insurance control authorities to take urgent steps to ensure that all insurance companies are adequately capitalized so as to ensure their viability and ability to meet their financial obligations to policy holders ... in view of the importance of insurance in the social and economic development of the nation.

122. The Conference also recognized and supported the formation of the Association of Insurance Supervisory Authorities in Africa to promote harmony of action in the supervision of the insurance industry which will work closely with the African Insurance Organization in promoting the growth and development of a strong, healthy and viable insurance industry in Africa. Thus, the request for properly supervised standards of business that apply to the whole market came in the first place from the market itself. The Conference also emphasized the importance of competent and professionally qualified personnel as a means to ensure solvency and sound business practices, something that developing countries would be advised to give more attention to than in the past. In Brazil, the new requirements laid down by the National Private Insurance Council for directors of insurance companies, including academic training and a minimum period of experience in the insurance field, are considered to fill an important gap and should be an encouragement to other countries to take steps in a similar direction.

123. However, as suggested above, undercapitalization has not been the only issue. In Malaysia, the Director General of insurance is reported 39/ as setting about eliminating fraudulent practices, inadequate capitalization, slow premium collection and payments, premium and commission kick-backs and incestuous investment practices - all evils which do not exclusively affect the country where they originate. The Pakistan Government, 40/ has instructed the Federal Investigation Agency to investigate allegations of fraud and tax evasion in the insurance industry. Other countries are taking similar action or showing their concern. In Hong Kong, an Insurance Advisory Committee has been created to advise the Governor on matters pertaining to the administration of the regulations and the conduct of insurance business. The Committee is said to have been particularly active in matters concerning insurance companies' liquidations. At the heart of such information and declarations lie the general problem of solvency and sound business practices and the responsibility of the Government to ensure the fair performance of the companies in the domestic market.

124. On more specific and technical levels, the liquidator of an important insurance company in the United States gave his opinion on the causes of insolvency, setting out a list of main dangers and corresponding remedies which are worth recalling, 41/ namely:

- Managing general agent contracts that completely delegate authority for underwriting and reinsurance placements be outlawed;

- A regulatory authority be established to accredit alien reinsurers. Accreditation requirements might include minimum capital and surplus; the filing of annual financial statements; periodic on-site examinations by federal authorities; and minimum standards for collateral that alien reinsurers must post for the benefit of domestic ceding companies;

- Greater responsibility be imputed to the directors and officers of insurance companies and on the insurers' holding companies for the failure of a company;

- Controls be placed on fronting operations;

- Officers and directors of insolvent companies be prevented from later mismanaging other insurers.

1. Share-capital

125. In a number of developing countries regulations have been laid down to the effect that minimum share-capitals be increased. In many of these countries, however, it is difficult to say whether the new amounts are just meant to offset currency depreciations or will effectively result in an increase of net worth in real terms, leading to the growth and expansion of the industry and its retention capacity and to an improvement of its services to the public. The new requirements have resulted in some market concentration, as small companies which could not meet an adequate level of capitalization had to merge with other companies.

2. Technical reserves and investments

126. Another field of regulatory action in certain countries has concerned the process of shifting from strict compulsory investments of the technical reserves and guarantee funds to a less rigid régime, where the initiative of the companies was allowed to play a larger role. For many years, insurers have considered that the combination of high reserve requirements and forced investments in low-interest government securities have crowded out private sector borrowing and increased the price of insurance. The negative effects have notably been felt in the life insurance business, where the insurers' investment incomes have a strong incidence on premiums - investment income being one of the major components of the levelled premiums, so that lower interest rates are directly reflected in less attractive premiums for the insured.

127. Therefore, a more liberal approach to insurance investments has been perceived in some developing countries (often associated with liberalization of financial flows). This does not mean, however, that Governments have now revoked the obligation that investments be effected locally, applying in particular to foreign insurers who tend more than domestic ones to invest in countries where higher interest rates and more stable currencies can be obtained. The example of the Bahamas is illustrative of this stance. A Central Bank report has recommended that foreign insurance companies operating in the Bahamas should be required by law to invest locally the bulk of funds generated in the country. "The increasing outflow in non-merchandise insurance, particularly in the area of head office expenses has been and is a

cause of great concern to Bahamian authorities ... . In the interest of development, the authorities cannot and should not continue to allow domestic savings to be used to generate income and employment abroad to the detriment of the Bahamas". 42/

128. Several countries have enacted new rules on reserve requirements. In Mexico, as an example, the rules cover now, in addition to premium reserve on unexpired risks and other technical reserves, a reserve for currency fluctuation. The contingency reserve for life business will be equivalent to 1 per cent of net premiums written during the year; the corresponding figure for accident, health and property insurance is 8 per cent.

3. Contracts, tariffs, intermediaries, taxation.

129. On the question of intermediaries, it is worth noting that the Association of British Insurers has introduced a new Code of Practice for the selling of general insurance. The code applies to all intermediaries, including employees of insurance companies, other than registered insurance brokers. It is felt that a number of developing countries, where the activities of non-regulated agents and other intermediaries are a cause of concern, might wish to consider the pertinent points of the new United Kingdom code that could be applicable to their own countries.

130. Some of these countries have already taken action in the sense of more effective services and a better performance of intermediaries. Thus, in Indonesia, insurance agents are now licensed only after successfully passing qualifying examinations conducted by the Insurance General Association of Indonesia. A Ministry of Finance Decree (1987) confers upon the Insurance Council of Indonesia the authority to license life insurance agents. Insurance brokers are required to have a paid-up capital and a deposit with the State-owned bank. The entire capital should be in the hands of Indonesian citizens and/or national companies and must be in the form of a limited liability. In Malaysia, pre-licensing requirements have been strengthened for new agents as of 1 January 1988.

131. Some countries have increased taxation on insurance premiums. As usual, insurers claim that new taxes discourage insurance and deter existing policy holders from opting to more extensive covers. The Philippines insurance industry continues to appeal to the Government to rationalize taxes on the industry with the ultimate objective, they said, of promoting growth of the industry, particularly the life sector. In the United Republic of Tanzania, foreign companies have been strongly resisting payment of the taxes on the grounds of "obvious loss of revenue". In Venezuela, a new "presumed tax" on all payments abroad, including those for reinsurance, will now be levied. The tax has been established as 30 per cent on premiums ceded to reinsurers.

B. Some other country developments

1. New legislative and supervisory systems

132. Cameroon: The full implementation of the Cameroon Insurance Ordinance, 1985, was effected during the period under review. The Ordinance contains a number of provisions affecting the capitalization, ownership, management, licensing and supervision of insurance companies, as well as matters affecting the business of reinsurance.

133. Ghana: The tightening up of the Ghanaian insurance regulatory system is under study. The office of the commissioner would be separated from the Ministry of Finance.

134. Guinea: A new Ordinance reflects the structural change of the insurance market (see chapter I) and established rules for the licensing and control of new insurance companies in the country. The Central Bank is given responsibility for the administration of the law and for granting the licences to the applicants.

135. Kenya: The Insurance Act 1984 came into force in 1987. It includes provisions on capitalization and solvency margins, as expected, and also on ownership (foreign companies are required to sell at least one third of their share to Kenya nationals) and on appointments: the appointment of managers and other executives must first get the approval of the Insurance Commissioner.

136. Mauritius: The implementation of a new insurance act of 1987 is under way.

137. Zimbabwe: The provisions of the Insurance Act and of the Zimbabwe Reinsurance Corporation Act 1983 were fully implemented during the period under review. The Registrar of Insurance has now been replaced by a Commissioner with wide-ranging powers, some of which had previously been exercised by the Minister. These include the right to demand details of an insurer's premium rates and policy conditions, and to call for adjustments. For the first time, the Commissioner may prohibit certain practices or methods of conducting business. Margins of solvency are now prescribed.

138. Bahrain: An insurance law was promulgated in 1987 providing for control and supervision of insurance companies registered in the country. No new foreign companies will be registered. The law prohibits direct insurance abroad, except in special cases where a prior authorization is necessary.

2. New regulations on share-capitals, solvency and accounts

139. Brazil: A special Commission has been appointed to study draft standards relating to the margin of solvency. As a preliminary measure, it introduced a new system for the calculation of technical reserves on outstanding risks.

140. Colombia: Capital requirements for Colombian insurance and reinsurance companies have for the first time been established in the form of a resolution by the country's supervisory authority. 43/ Press reports point out that "in the wake of a series of scandals and financial collapses that have shaken Colombia's banking industry and the Bogota Stock Exchange, the authorities are expected to tighten up the capitalization regulations governing insurance companies in Colombia. For years, it has been an open secret that many insurance firms in Colombia are perilously under-capitalized".

141. Jordan: Companies must now write aggregate annual premiums at least five times the total amount of its deposits.

142. Singapore: An amendment to the Insurance Act in January 1987 sets new conditions for the annual returns. The role of auditors is expanded; they are now required to submit a supplementary report on (1) Areas of weakness in

accounting and internal control systems; (2) Situations of conflicts of interests involving the management; (3) Comments on the implementation of previous recommendations made by the authority; (4) Non-compliance with the Insurance Act, Notices or Directions issued by the authority.

143. Republic of Korea: A policy holders' guarantee fund against insurer bankruptcies has been set up. It will be based on obligatory contributions of 0.1 per cent of premium income from both local and foreign companies. In a further measure to protect the interests of policy holders, new entrants to the insurance market are obliged to deposit over 30 per cent of paid-up capital with the Insurance Supervisory Board, although the deposit is refundable once the company has a proven track record.

3. New measures on compulsory insurances

144. Côte d'Ivoire: Transport insurance for all imports is now to be taken out locally. Similar provisions have been laid down in Togo, together with the obligation to insure motorists against third party risks.

145. Motor insurance will be compulsory in Bahrain, Venezuela, Uruguay and Colombia. In the latter country, available reports show that the situation is comparable to many other developing countries: "In theory, mandatory insurance has been in effect for a number of years, but in practice the rules were not enforced." Now, to ensure that the new provisions are effectively implemented on a national basis, insurance companies must submit monthly details of new mandatory automobile policies to the State National Transport Institute, which will maintain a public register on all such reports.

146. On policy conditions and other aspects of contractual relationship some country developments follow:

147. Morocco: New rules concerning the determination of the compensation to be paid to victims of motor accidents is being implemented. It contains a table of compensation payable to victims in different categories and sets out limits of compensation payable so as to ensure that the courts do not exceed these limits in the awards of amounts applicable to the age, social status and circumstances of the particular victim.

148. Senegal, as well as several other countries is considering the setting up of a guarantee fund to provide indemnities to victims of motor accidents where responsibility falls upon uninsured or unknown drivers.

149. Zimbabwe: Companies will facilitate payment of premiums by allowing monthly instalments of the annual premiums, either directly or through brokers. To this effect, some insurers have negotiated with finance houses to provide their clients with a credit facility.

150. Pakistan: The department of insurance has asked all private general insurance companies to submit full information about the treatment of claims. The information is being sought after reports speak of malpractice in respect of claims payment. A questionnaire seeks information about claims received by the company including the reasons for declining or disputing any claim. It also seeks information about claims accepted and paid by the company, and about outstanding claims during the year. 44/

151. Also in Pakistan, the National Insurance Reform Committee set up to curb malpractice in import and export insurance has recommended that premiums must be deposited by insurers immediately upon the issue of a letter of credit by banks. This should curb the present malpractice whereby premium payments are delayed until such time as a policy is issued. Currently, the premium is often not paid on the issue of a cover note, but only when the consignment has been received. In what has been described as an insurance racket, the agents issue a cover note without payment of the premium and importers are able to open a letter of credit with the banks on the basis of an all-risk policy. Once the goods have safely reached their destination, the all-risk policy is changed to a "total loss policy", involving a much cheaper premium than the all-risk cover. Press reports 45/ affirm that billions of rupees in payment to the insurance sector, both private and public, are being withheld. The new measure is expected to halt this trend and make it difficult for companies to use dishonest means.

Chapter V

NEW DEVELOPMENTS IN THE FIELD OF RETENTION CAPACITY AND REINSURANCE

152. New developments in the field of reinsurance have affected developing countries mainly in their capacity as buyers of reinsurance, predominantly from abroad. Therefore, trends and policies of the international reinsurance markets have often a direct impact on their insurance sector. But developing countries are also concerned in their growing capacity as reinsurance sellers to local and foreign companies.

A. Developing countries as reinsurance buyers

153. In general terms, as insurance buyers, developing countries have manifested two sorts of opinions: the first is directly connected with the shortcomings of the international markets, as shown in chapter II, section E. Reinsurance markets have stiffened their conditions: reinsurance cover (treaties and facultative) is now more expensive and more difficult to come by; problems of insolvency of major reinsurers, however exceptional, do exist sometimes calling into question the solvency of their clients and the very existence of some small markets in developing countries. So far, the crucial problems of reinsurance supervision and of an international system monitoring the soundness of the reinsurance companies have not found an adequate response.

154. Other problems exist in that international reinsurers now insist that premium reserves are not withhold by ceding companies. It is worth recalling in this respect that resolutions adopted in the framework of UNCTAD called on insurers of developing countries to invest in their countries their technical reserves, including reinsurance premium reserves. This resulted in reinsurance premiums being paid out as risks occurred - not before as is the case when technical reserves are not withheld. A consequence of this policy was that ceding companies benefited from the investment income on those reinsurance reserves. This policy is now challenged, to the detriment also of the balance of payments of the countries concerned. As W. Olotch, Chief Underwriter of the African Reinsurance Corporation, recently pointed out "Pressures are being exerted by international reinsurers for the reduction or elimination of premium reserves as a way of improving the cash flow on treaties and to minimize the loss on investment income".

155. Other problems have arisen: "Commissions payable on proportional [reinsurance] treaties have not been spared and at each [treaty] renewal, reinsurers are demanding a reduction on the otherwise high commission rates that were the order of the day in the past ... Insurers and reinsurers in Africa and Asia are also being faced with higher rates on their excess of loss protection. In some cases, the experience even in working covers does not seem to justify the increase in these rates. Again, because of their current stronger position, international reinsurers are able to quote rates that would not otherwise have been competitive a few years ago". Taking into account the fact that business from developing countries has been profitable, the above measures will certa ıly result in higher technical profits being made by reinsurers accepting business from African and Asian countries.

156. As an indication of the profitability of this business, a representative of one of the leading international reinsurers with extensive business connections in Africa stated that in Nigeria profits had been approximately 12 per cent of the premiums written. Most interesting of all, the same speaker, assessing their actual margin, after allowing for delays in receiving the balances due to them and other factors, was of the opinion that a margin of approximately 4 per cent was still being realized.

157. International reinsurance markets point out, however, that it is a well known fact that business from developing countries is unbalanced because of the few peak risks, and while a reinsurer in this environment can make a profit for a number of years, a single loss in one year can claim all the profits previously realized over a long period. Nevertheless, by all accounts premiums that developing countries have exported during the period under review have reached relatively important proportions. It is worth quoting in this respect the report of an address by the Executive Secretary of the African Reinsurance Corporation, Eyessus W. Zafu to the African Insurance Organization in Brazzaville (1987).

> "He estimated the reinsurance premiums that African markets currently generate at approximately $US 2.03 billion, i.e. 60 per cent of non-life and non-motor business and 15 per cent of life and motor. What is effectively paid out depends on profitability of those reinsurances, on which not much published data exists. However, both African (reinsurance buyers) and their reinsurance sellers tend to agree that, by and large, reinsurance cessions from Africa have consistently produced credible underwriting profits. This assertion is confirmed by the operating profits of Africa Re.: 20 per cent for fire and accident and 22 per cent for marine and aviation classes. If these results serve as an indication of the whole business, the net capital transfer estimated for 1986 was in the region of $US 400 million, without considering investment income on net premiums paid or reserve deposits retained by ceding companies."

158. Obviously, recalled Mr. Zafu, "African companies need the reliable international reinsurer not only for providing reinsurance capacity but also for his technical expertise and support. Although, perhaps not to the same extent, the reinsurer whose primordial objective is profit, also needs the African cedant whose reinsurance portfolio, even at times when business from the developed markets produced disastrous results, consistently achieved positive technical margins. There are serious and real disparities in the competitive positions of the two parties to the reinsurance contract and it is logical to assume that the stronger party will aim at and is often capable of extracting more advantages from the weaker party. The demands of high prices and restricted conditions by the reinsurer will exacerbate even more the already stringent exchange control regulations ..."

159. Governments, too, are not satisfied with the course of events in the reinsurance scene. Some of them think that the local markets have some responsibility in the situation to the extent that these markets do not develop an adequate policy of optimizing risk retention - and saving reinsurance premiums paid in hard currencies. Some Governments have specifically expressed concern at what they consider an unwarranted outflow of foreign exchange resulting from the dependence on developed reinsurance

markets to service their reinsurance needs. They point out that some domestic insurers have ceased to be risk carriers but have become instead the conduit for exporting premiums abroad through unnecessary reinsurance, fronting or similar arrangements - i.e. they buy reinsurance for the totality of the risk they have insured, for a premium differential and the possibility of investing the premiums before claims are paid.

160. Bernard Chidzero, Senior Minister of Finance, Economic Planning and Development of Zimbabwe, has clearly expressed these sentiments in the following terms: "Hitherto a great deal of premium income originating in our countries has been shipped abroad and in scarce foreign currency, thus affecting our balance of payments and resulting in the compression of imports through a shortage of foreign currency. This state of affairs negates economic growth and development; it should and can be avoided through increased insurance capacity retention". He added that the outflow of foreign currency from the continent has been exacerbated by the reliance of African countries on expatriate insurance management skills, leading to outside payments of management fees. 47/

161. While some markets fared better - particularly in Latin America, where retention rate rose from 28 per cent in 1980 to 45 per cent in 1986 for private insurers, and from 38 per cent to 47 per cent during the same period for state-owned insurers - there is no doubt that reinsurance problems and the difficulties experienced during the period under review are influenced by the problems of insurance capacity in the individual countries concerned. The following paragraphs illustrate national policies in the field of reinsurance pertaining to (a) the setting up of new local reinsurance institutions; (b) recent developments regarding changes of market structures, compulsory reinsurance cessions and new regulatory frameworks; (c) other measures aimed at increasing local retention capacity and improving the effectiveness of reinsurance services.

1. The setting up of new reinsurance institutions

162. Nigeria: Three new reinsurance companies, wholly owned by Nigerians, have been set up over the last five years. Local authorities and the State-owned Nigerian Reinsurance Corporation have reportedly encouraged this development by insisting that foreign reinsurance should not be resorted to until local capacity is exhausted. More companies are said to be in the formation period. This, however, is considered in some quarters as a negative proliferation and a result of the erroneous belief that additional reinsurance companies are equal to an additional domestic capacity. Beyond a certain quantity of companies, however, the converse is often true.

163. Senegal: The Société Sénegalaise de Réassurance, the first reinsurance company in the country, has been set up with the participation of the Government, the insurance market and French reinsurers. The new company enjoys certain privileges in that, for example, all domestic insurers in the market are obliged to reinsure with it 15 per cent of the existing reinsurance treaties and 6.5 per cent of the written premiums. Foreign insurers have to reinsure 20 per cent of the premiums written.

164. Indonesia: Another company joined the existing three reinsurance companies operating in the market. Further, the Minister of Finance requires that every reinsurance company should increase its paid-in capital.

2. Recent changes in market structure, compulsory reinsurance cessions and new regulatory frameworks

165. Sri Lanka: The domestic reinsurance system was drastically changed by the Government in the latter part of 1987. The Insurance Corporation of Sri Lanka was the sole source of outward reinsurance placed directly overseas, except for the compulsory cessions on fire and marine business to the National Insurance Corporation. As of 1 January 1988, with the opening of the market to the private sector, the insurance companies are allowed to handle their respective reinsurance needs themselves and to buy reinsurance in whatever market they think appropriate.

166. Brazil: The monopoly of the State-owned domestic reinsurance supplier, currently held by the Instituto de Resseguros do Brasil, may soon end if proposals from the private sector regulatory body are accepted. The latter favours allowing private sector insurers to band together to reinsure large risks, with the IRB's monopoly confined to the purchase of overseas cover.

167. Islamic Republic of Iran: More normal relations with the international reinsurance market have been established following what is now seen as a temporary interruption of all remaining outward reinsurances in 1985. Press reports 48/ indicate that the Government now requires that all Iranian companies cede to the State-owned reinsurance corporation the excess of their own retention capacity. The reinsurer will keep an account for the business thus transacted, together with the excess of its own retention capacity, in a National Reinsurance Pool. The reinsurer will then be allowed to seek retrocession cover from the international market on a reciprocal basis, preferably from Islamic and other developing countries' reinsurers.

168. Kenya: The Kenya Reinsurance Company, with which the national market had the obligation to reinsure 25 per cent of their business, has increased these compulsory cessions with a participation of 10 per cent to all reinsurance treaties that insurers have in force.

169. Mauritius: The new Mauritius Insurance Act which came into force in 1987 provides for statutory cessions to the State Insurance Company of Mauritius (SICOM), which is to become a limited liability company owned by parastatals whose shares are offered in the stock market.

170. Republic of Korea: Presently, insurers are obliged to reinsure with the State-owned Korea Reinsurance Company. Under the proclaimed open-door policy of the insurance market, the Government will abolish this system by 1990. A reinsurance liberalization scheme will be carried out on a gradual basis to allow the insurance market to adapt to changed conditions and maintain stability of the reinsurance operations.

3. Other measures aimed at increasing local retention capacity and improving the effectiveness of reinsurance services

171. Thailand: Insurance companies are now required to place at least 10 per cent of their reinsurance treaties from the fire and marine business in the local market. It is reported that for 1987 this measure has already resulted in conserving foreign exchange amounting to 47 million baht in fire and about 58 million baht in marine, although results of only one year cannot be considered as a valid indication of the final outcome. As an incentive, special rates for fire and all risks insurance, where the sum insured is not less than 300 million baht, are granted for any insurer retaining at least 30 per cent of such risk locally. These special rates are only given where the average annual claim experience is not over 10 per cent of the total three-years premium.

172. Mexico: Less in terms of reinsurance premiums is now being paid abroad as a result of the increase in gross treaty capacity that local insurers seem to have at their disposal and the increase in captive business fronted by local companies. It is reported that "companies tend to seek higher treaty limits rather than placing peaks facultatively because they can thus keep a substantial premium reserve [which would not be permitted if reinsurance was bought on a facultative basis], thereby improving their cash flow." 49/ The ever-present earthquake factor in Mexican reinsurance business makes certain classes of reinsurance from Mexico a less than attractive activity. However, a new approach to the reinsurance of earthquakes may be the start of a new trend. 50/ One of the most important companies has abandoned the traditional practice of arranging outward protection for its earthquake covers via proportional fire treaties and is now retaining all earthquake risks in its own account, protected by an excess-of-loss-programme purchased in an overseas market. It is also reported that other Latin American companies, especially those in countries exposed to seismic activity, are now studying the introduction of similar programmes. The temptation to retain earthquake premiums is particularly strong at present because of the sharp rise in rates in the aftermath particularly of the 1985 Mexican earthquake. The risk that this temptation clashes with the prudent standards of protection through reinsurance (treaties and facultative) should not be overlooked.

173. India: The net premium retention (i.e. gross premium written less reinsurance premium paid abroad) has been increasing over the years and is currently about 87 per cent (as against 40-50 per cent for the developing countries as a whole). As can be expected, the lowest retention still applies to the Aviation and Marine Hull business, which are marked by high concentration of risks and an outstanding potential for big losses. The policy of avoiding reinsurance for motor business, characterized by a high spread of risks, is still maintained.

174. Nigeria: The Government and Nigeria Reinsurance Corporation now insist that no more personal lines reinsurance, including life and motor, can be bought overseas after 1 January 1989.

175. Zimbabwe: The Zimbabwe Reinsurance Corporation Act has defined the purpose and objectives of the Corporation and makes provision for compulsory cessions to the company by other registered insurers carrying on business in the country.

B. Developing countries in their capacity as reinsurance providers

176. As suggested above, developing countries have also experienced some hardships as reinsurance sellers. As already pointed out above (chapter II, section E), their insistence on reciprocity has sometimes turned out to be a source of additional difficulties. The quality of the business (i.e. the average profit margin) accepted has generally not compared with that of the business ceded. The result has frequently been that operations accepted from the international markets in reciprocity to the business ceded have not offset to the degree anticipated the reinsurance costs for the latter; on the contrary, the two results have often been negative, adding up to unexpected losses.

177. The Managing Director of the Korean Reinsurance Corporation (Republic of Korea) describing the situation for this country as an "unpleasant experience", said it was the main factor in the negative attitude towards overseas markets. In their rush to internationalize their business and attract reciprocity for their sizeable volume of outward placing, the Republic of Korea insurance companies had ended up with a great deal of undesirable inward business which had yielded nothing but losses since 1981. In 1981, these companies accepted premiums of $122 million which lost 5 million. Although premiums were then reduced, losses escalated up to 1984. In that year, the inward account lost $35 million on premiums of $58 million, an underwriting deficit of 60 per cent. Between 1983-1987, the bottom-line loss totalled $137 million. The picture remained bad and by last year premium income had been cut to $28 million, while losses totalled $16 million. Outward business from the Republic of Korea, meanwhile, has been of varying quality. In 1986 it produced a profit of $44.9 million for the reinsurers on premiums of $169 million, while in 1987 there was a small loss on premiums of $179.8 million as the claims ratio rose from 65 per cent to 80 per cent. 51/

178. The problems on that score are widespread, at least in Asia. An example, reported by a correspondent, would suffice: "Reports from the Philippines indicate that in 1986 alone, the industry experienced a high loss ratio of 94 per cent on business assumed from unauthorized (foreign) concerns, compared to the business ceded to them which posted a loss ratio of 44 per cent. Considering that this is the trend in the reinsurance transactions of most developing countries, it can be safely surmised that bad results on inward reinsurance increased the foreign exchange outflow and contributed to the balance-of-payments problems in the region. But some exceptions also exist ...".

179. A similar scenario is reported from several countries in Africa. Accordingly, Mr. Eyessus W. Zafu recommended, in an address to the African Insurance Organization Conference in Brazzaville (1987) that the utmost caution be exercised in accepting non-regional international inward business from markets one is not familiar with, to check the emergence of net negative transfers which have recently characterized the operations of many African companies.

180. The above difficulties on international markets in developed countries would lend credibility to the concept of an increased reliance on reinsurance markets of the developing region as both an outlet for reinsurance and a source of inward business. Every market would be both ceding surplus risks to

other markets in the region with idle capacity and making use of its own capacity for accepting business from those markets, whose characteristics would be better known by both ceding and accepting companies. But the issue is not that simple as pointed out by E.W. Zafu: "Africa still has severe communication problems, with unreliable telex, post and telephone networks. Travel is hindered by restrictive airline routes and timetables, and on top of this, prior written approval is required from appropriate ministries before even general managers from some countries can go abroad". A major obstruction to greater co-operation concerns remittances of reinsurance balances where a combination of lack of funds, unconvertible currencies, devaluation and exchange controls have contributed to the present crisis.

181. Daniel Potounjou Taponzie, General Manager of the Caisse national de réassurance, Cameroon, developed similar concepts:

> "Most African reinsurers have contracts with their ceding companies only through correspondence and at international meetings. Very few insurers, if not any of them, think of visiting their African reinsurers to have an idea of their organization, the political and economic context in which they operate, their faith in their enterprise. This attitude, which could be qualified of reciprocal mistrust, impede ... the sharing of experiences and (explains) the continued dependence on foreign reinsurers for the definition of the technical conditions of the risks coverage, (while) with the present technical level, Africans could do without foreign assistance in certain fields. However, many African ceding companies seem to continue to prefer their relations with international reinsurers. Their African partners are not often informed of the characteristics of the risks they cover or are the last people to be informed thereof. It goes without saying that Africa still has serious problems in the field of telecommunication. But we are talking here of voluntary silence. A few years ago, insurance companies started sharing their know-how. But unfortunately, it is with regret that we see the process slowing down instead of expanding. As a consequence of the situation described above, reinsurance accounts take an inordinate time to reach African partners. As far as balances are concerned, their settlement becomes at times hypothetical. Now African reinsurers, just like any other reinsurers, can fulfil their commitments after accidents only if they have enough financial resources, which financial resources can only proceed from settlements by ceding companies. The big delays in these settlements lead to a situation where business which technically have a substantial surplus end up having a financial deficit due to devaluations of depreciations of subscription currencies ..."

182. However, in spite of all these shortcomings, the idea of increasing co-operation among developing countries and the encouragement to individual companies to adapt their retentions to their genuine capacities have made progress in the period under review. In particular, exchange of business through pools and other institutional arrangements has received a strong impulse, often thanks to the initiatives carried out by international trade organizations and other bodies in developing countries concerned with such issues. As a result, the period under review witnessed the establishment of some pooling arrangements between different African and Asian markets, such as

the African Insurance Aviation Pool, the WAICA Reinsurance Pool and the East African Insurance Fire Pool. Discussions aimed at the establishment of the African Insurance Organization Oil and Energy Pool and the African Insurance Clearing House also started during the period.

183. Some major achievements in this area were: At its 14th Conference (Brazzaville, June 1987) the African Insurance Organization (AIO) urged a "progressive increase" of individual companies' retention, along with the establishment of continent-wide mechanisms to stem what is perceived as a massive flow of capital out of developing regions, particularly Africa.

184. At its 15th Conference, (Harare, 7-10 June 1988) the AIO again recommended its members to continue their efforts regarding the formation of insurance pools, to retain in this way a larger percentage of premium within the continent. Not all have shared this opinion, however, and scepticism has been expressed of the African industry's overall ability to retain a larger chunk of the risk. A problem is seen in the portfolio imbalance judged typical of business from the African continent. According to this view, underwriting results have deteriorated in Africa since 1981 and capital and reserves are frequently too low for local companies to undertake the expansion proposed. 52/

185. Other international reinsurers often contend that the risk-bearing or retention potential in these regions is very low, and that an increase of retention limits will probably result in unstable underwriting results and financial catastrophes for the insurance industry. In fact, both parties are right, because they refer to different subjects. In one case, the issue is global capacity of the countries and regions concerned, which could surely be enhanced provided the formidable institutional problems that a project of this kind would involve be solved. In the other case, the issue is the capacity of the individual companies and of the respective markets, which indeed is often very restricted and calls for prudent retention limits - and hence large reinsurance outflows (see also the opinions expressed in chapter II).

186. Identifying the "financial limitations" of African markets as a major obstacle to progress, it has been proposed to create "autonomous financial institutions for the investment of reinsurers' underwriting reserves within the respective national economies, under the joint management of reinsurers and ceding companies. The suggestion was considered by the above AIO meeting as reasonable but requiring further studies".

187. The Organization of East African Insurers has revised its constitution and set up new objectives, which include the encouragement and promotion of the exchange of insurance business among member countries and efforts to conserve foreign exchange within the region and the establishment of regional reinsurance companies and pools. The Organization will encourage the free flow of intraregional insurance business and promote the enactment of appropriate legislation in the member countries.

188. The African Reinsurance Corporation has increased its share capital and its shareholders. Madagascar and Rwanda have become members, bringing the total to 38. It is said that more countries are expected to join the intergovernmental reinsurer in the near future.

189. The Arab Reinsurers' Association has been formed with the aim "to improve utilization of capacity". Ten of the 13 reinsurers registered in Arab countries are members.

190. Pakistan, the Islamic Republic of Iran and Turkey will shortly set up a fully-fledged reinsurance company to retain in the region "premiums which currently flow to the developed nations", according to the Chairman of the Pakistan Insurance Corporation.

191. The Asian Reinsurance Corporation has undertaken a feasibility study for the setting up of a regional reinsurance pool for aviation business to help the markets of the region to retain a larger proportion of this business and further develop expertise in this area.

192. Members of the ASEAN Reinsurance Pool have set up a company in Singapore to formalize their relationship. The membership of "ASEAN Reinsurance Corporation" is shared by all insurance markets in the South-East Asian countries of Brunei, Indonesia, Singapore, Malaysia, Thailand and the Philippines.

193. In October 1988 the chief executives of African reinsurance companies met in Cairo under the auspices of UNCTAD. The objective was to urge African and other developing countries to develop their own national insurance and reinsurance institutions so as to reduce their dependence on the developed countries. The participants proposed that bilateral exchange of business between African insurance and reinsurance companies should be given urgent priority. Such meetings will be continued in the future.

Notes

1/ See Official Records of the Trade and Development Board, Fifth Session, Supplement No. 3 (TD/B/118/Rev.1), annex I, sect. A. para. 6.

2/ The Review, London, August 1986

3/ International Research Services, November 1988.

4/ See World Bank's World Development Report, 1989, p. 130.

5/ World Insurance Report, No. 346, 16 September 1988.

6/ Ibid., No. 350, November 1988.

7/ Reactions, July 1988.

8/ World Insurance Report No. 296, 19 September 1986.

9/ Ibid., No. 301, 28 November 1986.

10/ Ibid., No. 340, 24 June 1988.

11/ Ibid., No. 363, 26 May 1989.

Notes (continued)

12/ Ibid., No. 290, 27 June 1986.

13/ Experiodica, Zurich, July 1986.

14/ World Insurance Report, No. 301, 28 November 1986.

15/ Ibid., No. 313, 1 June 1987.

16/ Ibid., No. 316, 10 July 1987.

17/ International Insurance Report, May 1988.

18/ The Review, January 1988.

19/ World Insurance Report, No. 318, 7 August 1987.

20/ Ibid., No. 365, 23 June 1989.

21/ Waica Journal, 22 March 1988.

22/ Fair Review, September 1988.

23/ International Research, April 1988.

24/ World Insurance Report, No. 336, 29 April 1988.

25/ Reinsurance Report, London, 17 October 1988.

26/ Robert Woodthorpe Browne: "The French Connection", in "The Review", London, August 1986.

27/ International Insurance Monitor, June 1985.

28/ Insurance Research, June 1989.

29/ See Waica Journal, 23 February 1988.

30/ See World Development Report 1989.

31/ See UNCTAD document "Reinsurance Security" (TD/B/C.3/221).

32/ World Insurance Report, No. 316, 10 July 1987.

33/ See the UNCTAD study on "Crop insurance for developing countries" (TD/B/C.3/163/Rev.1).

34/ See Waica Journal, August 1988.

35/ World Insurance Report, No. 318, 7 August 1987.

36/ Ibid., No. 319, 21 August 1987.

37/ Ibid., No. 333, 18 March 1988.

Notes (continued)

38/ International Research, September 1987.

39/ Reinsurance Report, 17 October 1988.

40/ World Insurance Report, No. 360, 14 April 1989.

41/ Business Insurance, 17 April 1989.

42/ World Insurance Report, No. 290, 27 June 1986.

43/ International Research Services, December 1988.

44/ World Insurance Report, No. 345, 2 September 1988.

45/ Ibid., No. 345, 2 September 1988.

46/ Reinsurance Market Report, No. 45, 1 December 1987.

47/ International Research, August 1988.

48/ World Insurance Report, No. 279, 23 January 1986.

49/ Ibid., No. 297, 3 October 1986.

50/ Ibid., No. 326, 27 November 1987.

51/ Reinsurance Report, 19 September 1988.

52/ World Insurance Report, No. 315, 26 June 1987.

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INVISIBLES: INSURANCE

Insurance in developing countries: review of developments in 1986-1988

Study by the UNCTAD secretariat

The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country or territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries.

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INTRODUCTION

(i) At its second session (April 1967), the Committee on Invisibles and Financing related to Trade requested the Secretary-General of UNCTAD "to carry out at least once every two years reviews of developments in insurance, with special reference to developing countries". 1/ The latest review, covering the period 1986-1988, has been prepared pursuant to this request.

(ii) The present study is a summary version of document TD/B/C.3/229, which bears the same title and which is being made available as a background document in order to conform with the secretariat's guidelines on reduction and limitation of documentation. That document contains detailed information on developments at the national and regional levels.

CHAPTER I

INSURANCE SYSTEMS AND MARKET CHANGES

1. During the period under review a tendency towards less strict conditions for the admission of new companies or the involvement of the private sector in insurance business has manifested itself in several developing countries. Most notable among these changes has been a general roll-back of policies instituted in the past to protect the insurance sector. In some countries, ownership of insurance companies has been opened to the private sector, domestic or foreign, in others the traditional rule that domestic property and liability may only be insured with companies in the domestic market has been relaxed. The obligation that local insurers have to take out reinsurance with a State-owned institution has also been removed in a number of countries and basic reforms on licensing, tariffs, contracts, and shareholding have been introduced.

2. This trend is in marked contrast to that of the 1970s, which saw the emergence of "domestication" policies for insurance in the developing countries. As a result, the dominance of foreign companies was gradually terminated, and many countries stopped the entry of new foreign companies. Others required the existing foreign companies to go into joint ventures with local companies. In line with an import-substitution policy, companies of the private sector, where it existed, were closely regulated: investment, tariffs, policy conditions and other activities were put into a rigid framework of internal rules. In some countries, the Government set up partial or total monopolies to handle reinsurance business. The companies' margin of freedom in respect of the selection of their reinsurers was otherwise tightly curtailed. As suggested above, the pendulum appears to have swung back in the middle of the 1980s, and more particularly during the period under review.

3. The specific motives behind this shift in approach are varied and not always clear to outside observers. Due to a lack of information from direct sources, it is also difficult to determine the pace, scope and the outcome of the reforms. Proper interpretation of available information is frequently rendered difficult by subjective reporting: the drafting of this document has had to rely intensively on trade journals, and only to a lesser extent on information from direct government or market sources.

4. A general conclusion, however, can be drawn: policy shifts, in the countries where they have occurred, are probably due to disappointment with traditional insurance patterns and reflect expectations that new concepts, giving larger room to reliance on market forces and outward-looking policies, will work better. More particularly, these concepts are based on the conviction that changes are indispensable if the market is to operate more efficiently and be able to provide the national economies and population with better insurance services - insurance services which should compare favourably, in terms of quality, policy conditions and price, to those available in other markets.

5. Two connected factors have often given impetus to these moves: on the one hand the insured community has become more demanding in terms of price and quality of the insurance covers and, on the other hand, the insurance industry

shaped by old market structures has proved less effective and competitive than expected. The alternative facing many developing countries was, and still is, whether to let the domestic companies overcome their learning period and keep them shielded from outside forces until they no longer qualify as "infant industries" and thus are able to stand up to international competition - or whether this course of action is too expensive for the country, in terms of losses by the insurance industry bearing on government budgets, costs to the insured community and poor quality of the services. The issue has often been raised by exporting industries in the countries concerned, for which reliance on the local markets resulted in higher insurance costs, which in turn increased production costs and resulted in a loss of competitiveness with a bearing on terms of trade. The issue was therefore part of efforts to improve the general effectiveness of economic policies.

6. Other influences seem also to have played a role:

(i) A major inducement for liberalization has been provided by international lending institutions, generally under "conditionality" programmes. This is particularly so in Africa, where "the World Bank is urging insurance monopolies to accept foreign participation in their shareholding". 2/ More generally, "about 30 World Bank financed projects are designed to assist Governments in privatizing State enterprises through sales, leases or management contracts"; 3/

(ii) Decisions to sell or privatize government-owned insurance companies have often been prompted by the financial losses that these companies incurred and by budgetary constraints - combined with adverse balance-of-payments positions and a growing debt burden. In one or two cases, the sale of companies has been directly linked to the need to raise foreign exchange to pay for external liabilities, sometimes within the framework of a "debt-equity conversion" programme. Also, sales of domestic companies have often been followed by renewed attempts by expatriate companies to establish subsidiaries in the markets, so that the country has been taken back to the situation where it stood before nationalization.

7. The African Insurance Organization (AIO), at its 15th General Assembly in June 1988, addressed an appeal to "all African Governments to recognize that insurance is a vital tool for economic emancipation and growth and as such its control and basic utilization should be in the hands of the nationals who are totally committed to the development of the country's economy". A widespread feeling at the above Conference was that the necessary assets for building up a genuine domestic industry were given up just when they started bearing fruit. In this context it has also to be noted that the World Bank itself has expressed strong reservations against privatization of financial institutions. 4/

8. These moves towards privatization on the other hand have been encouraged by the private industry, particularly but not only in Latin America. The "Declaración de Asunción", passed by the 21st Insurance Conference of the Southern Hemisphere (Asunción, Paraguay, 1987) for example refer to private insurance as "a key element in a democratic system, in that it guarantees the protection of persons, property and assets without requiring the high price of loss of liberty".

9. The process of liberalization might also be reinforced as a result of GATT's Uruguay Round of multilateral negotiations under way, which includes insurance, among other financial services. These negotiations may or may not result in fundamental changes in Brazil, India and probably other countries. However, designation of the former two countries as having "unfair trade practices" in the field of insurance under article 301 of the 1988 United States Trade and Competitiveness Act carries the possibility of economic sanctions and will increase pressures for liberalization. According to the World Bank's World Development Report 1989, it is often believed that countries which liberalize unilaterally (financial institutions) lose a bargaining chip that might be used at the GATT negotiations to increase their access to export markets.

10. It must be noted, however, that in certain countries, developments have gone in the reverse direction, i.e. measures have been taken to provide larger room for domestic companies or to admit only foreign companies if they are associated with domestic financial interests. This development has been particularly notable in markets where companies have mushroomed in the absence of any proper government policy.

11. Other structural changes of domestic insurance markets in developing countries have resulted from the expansion or the contraction of the domestic economies. The high income-elasticity of insurance makes insurance sales very sensitive to growth of GDP and sales volumes are in turn a major incentive for the creation of new companies - and the other way round. Stagnating or declining economies, particularly in Africa and Latin America, were reflected in a decrease in the number of companies in some countries, the same as expansive economies in a few countries of Asia resulted in a parallel expansion of their insurance markets. Several examples of structural changes of insurance markets are reported in the background document (TD/B/C.3/229).

CHAPTER II

OBSTACLES TO THE EXPANSION OF DOMESTIC INSURANCE COMPANIES AND OPERATIONS

12. The period under review has seen an aggravation of the obstacles to the expansion and the strengthening of domestic markets. This has resulted in several insurance companies becoming under-capitalized and under-reserved and has caused a considerable problem regarding their ability to perform properly the necessary functions.

13. In several countries, insolvency of insurance institutions, fragility of markets or their instability have been identified as the basic problems of the particular period under review. They are clearly related to one or more of the following issues:

(a) The influence of an adverse domestic macro-economic environment;

(b) The influence of specific technical factors, such as rates ceilings which are inadequate in view of claims in automobile insurance, excessive awards in courts, and the problems experienced by the marine insurance market in many countries;

(c) The influence of poor management, unsatisfactory regulation and supervision, and questionable business practices;

(d) The influence of a low risk-bearing potential, aggravated by important catastrophe-prone conditions;

(e) The influence of the external environment, particularly the international reinsurance markets and their operations.

A. The macro-economic environment

14. Prevailing economic conditions in many developing countries have resulted in a general decline in business activity in most sectors of the economy. In insurance, the decrease affected most classes of business, especially the motor, fire and marine business. Particularly affected have been countries of the Middle East hit by the slowdown of the economies of the oil States and the influence of the Gulf War.

15. Adverse economic conditions have also resulted in a dearth of foreign exchange and in monetary problems leading to currency devaluations. This has disrupted in many ways the normal business relations between domestic insurers and their foreign reinsurers. Difficulties in this respect have also prevented stronger co-operation among developing countries and an increase of their regional capacity.

16. Obstacles to the free and swift remittance of premiums to overseas reinsurers make negotiations with them even more difficult and erode the bargaining power of the reinsurance buyer. The situation encourages also the direct purchase of insurance abroad: foreign exchange for the payment of premiums is often more readily available to the local insured party (e.g. a shipping line) than to the insurer. Therefore there is a situation in which

dearth of foreign exchange prevents national insurers from underwriting local business and induces the insurance buyers to seek cover abroad, involving foreign exchange expenditure higher than before.

B. Technical factors

17. Motor, marine and some other branches have traditionally been difficult branches in many developing areas. In some of them, underwriting these classes of business has been more difficult than ever. Motor insurance is perhaps the most conspicuous example.

18. In spite of strong measures adopted by a few countries, the increase in accident rates and the absence of a corresponding rise in tariffs, have considerably worsened the underwriting accounts. Insurers often complain of antiquated tariffs, artificially held down by Governments in order to contain inflationary pressures, while Governments on their side often complain of the inability of insurance companies to manage their business better. One way or another, claims ratios (claims paid and due in relation to premium income) of more than 200 per cent are not unusual.

19. Marine cargo insurance has also given rise to concern. The problem here is usually not unprofitable underwriting, but a decrease of shipping activities. This is mostly felt in developing countries where Governments compelled importers to insure transportation risks locally and which have seen the provisions circumvented for all practical purposes through dubious business practices which increase the cost of imported goods. Poor communications have in the past led to much double insurance, with exporters considering the local coverage as a tax. The minimum coverage is purchased from the local insurer, frequently at the port of arrival (to comply with local legal provisions); the real insurance has been contracted with the exporter's own insurer on full conditions.

C. Other deficiencies

20. The slow pace in premium collection is a traditional difficulty in developing countries which has reached new heights in the period under review. At a recent general assembly of the Fédération des Sociétés d'Assurance de Droit National Africaines (FANAF), it was pointed out that the amount of unpaid premiums is reaching unacceptable levels: 70 per cent in some cases. Obviously, liquidity and solvency problems follow.

21. Inadequate supervisory systems are becoming a major obstacle to the soundness of the insurance markets. The World Bank has recently stated that "there is a growing recognition that effective prudential regulation and supervision are essential (to the process of liberalization of financial institutions)". 5/ Now, while the liberalization has not taken place in many countries, there has not apparently been an adequate effort towards meeting the essential condition of improving the supervisory systems. Some difficulties stemming from the inability of domestic insurers to collect indemnities from their overseas reinsurers surely result from shortcomings in the field of supervision and the lack of appropriate regulatory measures.

D. Low level of insurance capacity

22. The risk-bearing potential of the insurance industry has probably decreased during the period under review. Insurance capacity is largely based on a sound spread of the risks included in the portfolios of each of the companies participating in the market. The presence in the market of many small companies with a small premium income, coupled with an unprecedented accumulation of insured values and the threat of claims of catastrophic proportions are determinant factors for the low-risk bearing capacity of many markets.

E. External environment

23. Heavy reliance on international reinsurance markets has fortunately helped overcome a number of difficulties of developing countries in the field of insurance. The insurance industry in many of these countries can survive only thanks to the sharing of risks and the transfer of technology that reinsurance markets around the world provided. But this reliance has also brought with it some problems.

24. First of all, there has been a widespread problem of solvability of some international reinsurance companies - a systemic risk with potentially devastating effects, particularly for insurers in developing countries. 6/

25. Other problems relating to foreign reinsurance concern the so-called "reciprocity" business - reinsurance operations from international centres in which insurers can participate as a "reward" for the business they themselves cede to these centers. In general, reciprocity, which was meant to decrease the reinsurance costs or to offset these costs with reinsurance profits from inward business, has resulted in heavy losses. In particular, the quality of the risks being transacted appears to have been in many cases of the lowest quality.

CHAPTER III

MEASURES AIMED AT THE STRENGTHENING OF DOMESTIC MARKETS

26. The adverse conditions of the kind reflected in the above chapter affected many countries (not only developing ones) and by and large inhibited the expansion of domestic insurance markets. These developments did not, however, affect all developing countries. At the company level, efforts have been pursued to make management and administration more efficient. Many companies have begun or continued a process of computerization of their operations. This process has also been successfully introduced in some State insurance supervisory offices.

27. On a policy level, regional insurance associations have in several instances put forward new suggestions for the expansion and strengthing of the insurance sector. An example is the list of propositions put forward by the 14th African Insurance Organization Conference at Brazzaville (June 1987) which calls for:

- Consolidation of existing companies (especially reinsurers) before creation of new ones;

- International reinsurers to host a meeting of finance ministers to discuss settlement/exchange problems;

- African companies to recommend that their brokers place 25 per cent of outward reinsurance with African reinsurers;

- Companies to provide more statistics to back up African reinsurers; and,

- Encouragement to the development of African intermediaries.

28. The concern underlying these and similar recommendations is not only that present difficulties call for new approaches and a serious effort of adaptation of the domestic markets, but also that the risk-bearing potential of developing countries and regions must be fostered and improved.

A. New covers of particular interest

29. The last two years have seen the emergence of several insurance programmes that, beyond their commercial and profit-making interest for the underwriting companies and their usefulness for the insured community, had particularly stimulating effects on the economies as a whole. One of these programmes concerns agricultural insurance. Its importance has been highlighted at the World Insurance Congress (Quito, June 1988), where one of the resolutions adopted asked for the setting up of insurance companies specialized in that line of business in each of the countries concerned. Indeed, many of them are interested.

30. However, available information also shows that actual projects in this field have been rather scarce, and that some insurance programmes that were introduced have been totally or partially discontinued, due to the fact that

this cover is one of the most difficult to operate, particularly in developing countries. 7/ Crop insurance may also give rise to a considerable "moral hazard" or even fraud, and even without these it generally takes sizeable contributions from the Governments' budgets.

31. However, the possibility of setting up crop insurance programmes is given continued consideration in many countries, due to the potential benefits of rural covers on investment and output. Along with the traditional argument that crop insurance facilitates borrowing from credit institutions which enhances investments and crop outputs, it is also felt that crop insurance could help integrate into the stream of financial resources the sterilized assets (gold, etc.) that farmers are now hoarding in the expectation of crop failures that will inevitably hit them one day or another. At present, the benefits arising from these assets being made available to the domestic economy are generally not taken into consideration in the cost/benefit analysis of crop insurance projects and thus the overall advantages of this insurance for the national economies are often underestimated.

B. Other measures aimed at the strengthening of domestic markets: insurance education

32. The importance of insurance education was highlighted by the 15th African Insurance Conference (Harare, June 1988) which recommended that "in view of the present shortage of highly trained and experienced personnel in the African insurance business, concerted action should be taken by the industry to promote training and manpower development at company, national, subregional and continental levels and should be reflected in the annual budgets of all insurance companies and institutions". 8/

33. Examples of recent developments in the Asian region show a growing awareness that professionalism not only of key personnel of insurance companies but also of insurance intermediaries, brokers and agents is most necessary for the growth and development of the industry.

34. Meanwhile, it is also reported that, despite the recognition of the need for training, several existing insurance institutions have not been given the amount of support and financial means they need. Decreasing contributions from the industry and other funding sources - often stemming from decreasing premium incomes and less optimism about the growth of the industry resulting in cutbacks in training budgets - have affected the normal course of activities, or even threatened the very existence of these educational centres.

C. Self-regulatory measures, loss prevention and other measures

35. Several countries, particularly in South-East Asia, have started experimenting with self-regulation through inter-company agreements. In some of these and other countries, the Governments have also urged the insurers to police themselves. Negotiations to establish national loss prevention associations with the co-operation of the police, fire department and other authorities are also being undertaken by the industry.

36. New measures aimed at the expansion and diversification of the markets and the improvement of their insurance services are reported for a number of countries in the background document (TD/B/C.3/229).

CHAPTER IV

NEW REGULATIONS ON SOLVENCY, ADMINISTRATION, CONTRACTS

37. An increasing number of countries have come to realize that insurance can only grow and develop within the framework of effective legislation and a dynamic regulatory body, aimed at instilling discipline and cultivating business morality among insurers, professionalizing the business and developing insurance consciousness among the people. This philosophy has resulted in a number of countries putting more emphasis on prudential regulation and supervision, at the expense perhaps of product and price controls. More particularly, it has promoted the strengthening of insurance supervisory departments in some developing countries.

38. Insurance supervisory departments in the ASEAN countries have collectively set up an Early Warning System (EWS), patterned after the model set up by the National Association of Insurance Commissioners in the United States. The EWS comprises a set of financial ratio tests with which to detect those insurers likely to face financial difficulties. The EWS incorporates a point system to rank and prioritize the insurers for the purpose of review and inspections.

39. Meanwhile, the problems of undercapitalization and the need for action was taken up collectively at the 15th African Insurance Conference (Harare, June 1988). The Conference requested the African Governments through their regulatory bodies and insurance control authorities "to take urgent steps to ensure that all insurance companies are adequately capitalized so as to ensure their viability and ability to meet their financial obligations to policyholders ... in view of the importance of insurance in the social and economic development of the nation".

40. The Conference also recognized and supported the formation of the Association of Insurance Supervisory Authorities in Africa "to promote harmony of action in the supervision of the insurance industry which will work closely with the African Insurance Organization in promoting the growth and development of a strong, healthy and viable insurance industry in Africa". Thus, the request for properly supervised standards of business that apply to the whole market came in the first place from the market itself.

A. Share-capital

41. In a number of developing countries regulations have been laid down to the effect that minimum share-capitals be increased. In many of these countries, however, it is difficult to say whether the new amounts are just meant to offset currency depreciations or will effectively result in an increase of net worth in real terms, leading to the growth and expansion of the industry and its retention capacity and to an improvement of its services to the public. The new requirements have resulted in some market concentration, as small companies which could not meet an adequate level of capitalization had to merge with other companies.

B. Technical reserves and investments

42. Another field of regulatory action in certain countries has concerned the process of shifting from strict compulsory investments of the technical reserves and guarantee funds to a less rigid régime, where the initiative of the companies was allowed to play a larger role.

C. Contracts, tariffs, intermediaries, taxation

43. On the question of intermediaries, it is worth noting that the Association of British Insurers has introduced a new Code of Practice for the selling of general insurance. The code applies to all intermediaries, including employees of insurance companies, other than registered insurance brokers. It is felt that a number of developing countries, where the activities of non-regulated agents and other intermediaries is a cause of concern, might wish to consider a supervision mechanism that could be applicable to their own countries.

44. Several country examples on new regulatory issues and on new measures on compulsory insurance schemes are reported in the background document (TD/B/C.3/229)

CHAPTER V

NEW DEVELOPMENTS IN THE FIELD OF RETENTION CAPACITY AND REINSURANCE

45. New developments in the field of reinsurance have affected developing countries mainly in their capacity as buyers, mostly from abroad. Therefore, trends and policies of the international reinsurance markets have often a direct impact on their insurance sector. But developing countries are also concerned in their growing capacity as reinsurance sellers to local and foreign companies.

A. Developing countries as reinsurance buyers

46. Reinsurance markets have stiffened their conditions: reinsurance cover (treaties and facultative) is now more expensive and more difficult to come by; problems of insolvency of major reinsurers, however exceptional, do exist - sometimes calling into question the solvency of their clients and the very existence of some small markets in developing countries.

47. Insurers and reinsurers in Africa and Asia are also being faced with higher rates on their excess of loss protection. In some cases, the past loss-experience does not seem to justify the increase in these rates.

48. Governments, too, are not satisfied with the course of events on the reinsurance scene. Some of them think that the local markets have some responsibility in the situation to the extent that these markets do not develop an adequate policy of optimizing risk retention - and saving reinsurance premiums paid in hard currencies. Some Governments have specifically expressed concern at what they consider an unwarranted outflow of foreign exchange resulting from the dependence on developed reinsurance markets to service their reinsurance needs. They point out that some domestic insurers have ceased to be risk carriers but have become instead the conduit for exporting premiums abroad through unnecessary reinsurance, fronting or similar arrangements.

49. The background document (TD/B/C.3/229) illustrates national policies in the field of reinsurance pertaining to (a) the setting up of new local reinsurance institutions; (b) recent developments regarding changes of market structures, compulsory reinsurance cessions and new regulatory frameworks; (c) other measures aimed at increasing local retention capacity and improving the effectiveness of reinsurance services.

B. Developing countries in their capacity as reinsurance providers

50. Developing countries have also experienced some hardships as reinsurance sellers. Their insistence on reciprocity has sometimes turned out to be a source of additional difficulties. The quality of the business (i.e. the average profit margin) accepted has generally not compared with that of the business ceded. The result has frequently been that operations accepted from the international markets in reciprocity to the business ceded have not offset to the degree anticipated the reinsurance costs for the latter; on the contrary, the two results have often been negative, adding up to unexpected losses.

51. The difficulties on international markets in developed countries would lend credibility to the concept of an increased reliance on reinsurance markets of the developing region as both an outlet for reinsurance and a source of inward business. Every market would be both ceding surplus risks to other markets in the region with idle capacity and making use of its own capacity for accepting business from those markets, whose characteristics would be better known by both ceding and accepting companies.

52. Exchange of business through pools and other institutional arrangements has received a strong impulse, often thanks to the initiatives carried out by international trade organizations and other bodies in developing countries concerned with such issues. As a result, the period under review witnessed the establishment of some pooling arrangements between different African and Asian markets, such as the African Insurance Aviation Pool, the WAICA Reinsurance pool and the East African Insurance fire pool. Discussions aimed at the establishment of the African Insurance Organization Oil and Energy pool and the African Insurance Clearing House also started during the period.

53. At its 14th Conference (Brazzaville, June 1987) the African Insurance Organization (AIO) urged a "progressive increase" of individual companies retention along with the establishment of continent-wide mechanisms to stem what is perceived as a massive flow of capital out of developing regions, particularly Africa. Similar initiatives have been taken during the period by the Organization of East African Insurers, the Arab Reinsurers Association and the ASEAN countries.

Notes

1/ See Official Records of the Trade and Development Board, Fifth Session, Supplement No. 3 (TD/B/118/Rev.1), annex I, sect. A, para. 6.

2/ The Review, London, August 1986.

3/ International Research Services, November 1988.

4/ See World Bank's World Development Report, 1989, p. 130.

5/ See World Development Report, 1989.

6/ See Reinsurance Security: Study by the UNCTAD secretariat, TD/B/C.3/221, February 1987.

7/ See the UNCTAD study on "Crop insurance for developing countries" (TD/B/C.3/163/Rev.1).

8/ See, WAICA Journal, August 1988.

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REVIEW OF THE WORK PROGRAMME OF THE COMMITTEE

Review of the work programme of the Committee in the field of insurance

Report by the UNCTAD secretariat

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INTRODUCTION AND SUMMARY

1. The Trade Development Board decided, in paragraph 16 of its resolution 231 (XXII) of 20 March 1980, "to request the main Committees to review regularly the elaboration of their work programmes and the implementation of their decisions". Moreover, in paragraphs 6 and 7 of the Report of the Ad hoc Intergovernmental Working Group on the In-depth Study of the United Nations Intergovernmental Structure and Functions in the Economic and Social Fields (TD/B/1154), endorsed by the Board in its resolution 352 (XXXIV) of 20 November 1987, each of the main Committees is required at each regular session, without prejudice to its mandate, to (a) review the elaboration of its work programme and the implementation of its decisions; (b) consider and decide on the work ahead, including tasks to be introduced or prolonged in the work programme; and (c) ensure that any specific tasks be clearly defined with a timetable for their accomplishment.

2. Chapter I of this report briefly reviews the functions of the Committee on Invisibles and Financing related to Trade in the area of insurance and its work programme in this area, as well as major intergovernmental decisions having a bearing on the Committee's work programme. Chapter II provides a review of activities carried out in pursuit of intergovernmental decisions adopted by the Conference and the Committee in the area of insurance. In Chapter III the report discusses issues of relevance for the future work of the Committee.

Chapter I

FUNCTIONS AND WORK PROGRAMME OF THE COMMITTEE ON INVISIBLES AND FINANCING RELATED TO TRADE IN THE FIELD OF INSURANCE

3. The need for developing countries to build up a viable insurance sector of their own was recognized already at the first session of the United Nations Conference on Trade and Development in 1964. The Committee on Invisibles and Financing related to Trade is one of the three Committees that the General Assembly, in its resolution 1995 (XIX) of 30 December 1964, specitically decided should be established by the Trade and Development Board. Its terms of reference are contained in "Rules of Procedures of the Main Committees of the Trade and Development Board" (TD/B/740, annex II). In accordance with the terms of reference, the Committee on Invisibles and Financing related to Trade should inter alia promote, under the general guidance of the Board "general and consistent policies in the field of invisibles" (which includes insurance and reinsurance), keep under review the recommendations of the Conference and the Board in that field, and formulate recommendations thereon to the Board, "keeping in mind the objective of accelerating the economic growth especially of developing countries". 1/

4. The Committee on Invisibles and Financing related to Trade is the only body within the United Nations system which deals with issues of insurance on a consistent and regular basis. Since its establishment, the Committee has held 12 sessions. Since its eighth session in 1977, the Committee's sessions have been held in two parts, one on financing related to trade and the other on insurance. The first part of the thirteenth session of the Committee will be devoted to insurance. Questions of money and finance will be dealt with in the second part of the thirteenth session for which a separate note on the work programme will be prepared.

5. The Committee has carried out activities relating to both aspects of its terms of reference by formulating general policies for intergovernmental consideration with regard to the role of insurance in development and by launching processes to implement the intergovernmental agreements in that field. The establishment and strengthening of national insurance markets in developing countries has been given clear priority following recognition by the Conference that "a sound national insurance and reinsurance market is an essential characteristic of economic growth" (recommendation A.IV.23 adopted by the Conference in 1964). Mainly as a result of the discussions which had taken place in the Committee, the Conference laid down new lines of action at its third session. It stressed in particular the need for efforts to create insurance and reinsurance companies in developing countries; to invest locally the reserves accruing from insurance operations in those countries; to resort to local markets for the insurance of transnational investments in developing countries; and to strengthen co-operation among insurance and reinsurance industries of developing countries (Conference resolution 42 (III) adopted in 1972).

6. The International Development Strategy for the third United Nations Development Decade provided an important direction to the work of the Committee by recognizing that there was a need to establish or strengthen local insurance markets in developing countries and ensure that the terms and conditions of international insurance and reinsurance transactions should be equitable for, and meet the needs of, all parties concerned, particularly

those of developing countries. More broadly, the Strategy called for measures to encourage a more balanced international distribution of service industries and to assist developing countries in minimizing as far as possible their net outflow of foreign exchange from invisible transactions (General Assembly resolution 35/56, adopted on 5 December 1980, paras. 68 and 69).

7. At its sixth session in 1983, the Conference adopted resolution 159 (VI) on international trade in goods and services, which asks the secretariat to pursue its studies on the role of the services sector in development. It was also decided in the Ministerial Declaration adopted in 1986 at Punta del Este in Uruguay that "the negotiations on trade in services sector" held in the framework of the Uruguay Round would be carried out by the GATT secretariat and would take account of the work of the international organizations concerned.

8. The major development in UNCTAD since the twelfth session of the Committee which is of relevance to its work programme in the field of insurance has been the adoption of the Final Act of UNCTAD VII. Under the terms of the Final Act, UNCTAD should continue its work in the field of services. More specifically it is asked to analyse the implications of the issues raised in the context of trade in services and to explore appropriate problematics for trade in services, keeping in view the technological changes in the field of services.

9. The UNCTAD sections of the United Nations Medium-Term Plan for the period 1984-1991, as revised, reaffirm the general guidelines for the work of the Committee in the area of insurance. The objectives are, inter alia, to strengthen the technical, financial, marketing and institutional structure of the insurance sector of developing countries so as to reduce its dependence on international insurance and reinsurance centres; to provide support regarding the establishment and operation of adequate State insurance supervision and of appropriate training and educational facilities, and to promote a higher level of co-operation among developing countries in the field of insurance and reinsurance.

Chapter II

INTERGOVERNMENTAL DECISIONS AND THEIR IMPLEMENTATION

10. This chapter provides a brief review of the Committee's decisions in the area of insurance and of the activities of the secretariat since the twelfth session of the Committee; it may serve as useful background information for the Committee in reviewing of its own work programme.

11. The Committee has over the years addressed problems and formulated decisions in most of the major insurance fields of importance to developing countries. Questions of ways to increase local retention, improve education and training in insurance, deal with problems of reinsurance, and intensify regional and interregional co-operation have traditionally featured prominently in the discussions and decisions. At its more recent sessions, the Committee has emphasized the importance of adapting insurance contracts in developing countries to their own needs and characteristics. 2/ At its twelfth session the Committee drew particular attention to the need to introduce modern methods of risk management in developing countries. 3/

12. The discussions and decisions by the Committee have shaped the insurance work programme. The major activities which have been carried out since the twelfth session of the Committee in the area of insurance are briefly described below.

A. Research and policy studies

1. Reinsurance security

13. At the second part of its twelfth session the Committee discussed the issue of reinsurance security, and had before it a study by the UNCTAD secretariat on that subject (TD/B/C.3/221 and Supp.1). During that discussion, members of Group B and Group D requested the secretariat to clarify the relationship between the role of brokers and reinsurance security. Accordingly, the secretariat commissioned a study on the role of reinsurance brokers in developing countries. This study is annexed to the report prepared by the secretariat for the current session of the Committee entitled "Reinsurance security for developing countries" (TD/B/C.3/228). It summarizes certain key points of the above-mentioned two studies and formulates proposals for policy action that would enhance reinsurance security.

14. The Committee may wish to consider the proposals put forward in this report and decide on possible action by member countries and/or the secretariat.

2. Contribution to the Trade and Development Report 1988, Part two, which dealt with services in the world economy

15. Insurance is an important part of the services sector. The role of services in the world economy, international trade in services and the situation of the services sector in the national economy of developing countries were discussed in the Trade and Development Report 1988. In annex 4 of the Report, the influence of the insurance industry on economic activity, particularly of developing countries, the supply of insurance, issues regarding the international trade in insurance and the development of the production of and trade in insurance are discussed.

B. Review of developments in the field of insurance and reinsurance

16. A biennial report on recent developments in the field of insurance and reinsurance is prepared pursuant to a decision adopted at the second session of the Committee.

17. The secretariat also prepares as background material a statistical survey of insurance and reinsurance operations in developing countries. The most recent one, covering the period 1984-1986, is before the Committee at its current session.

C. Substantive support to technical co-operation activities

18. Close co-ordination has been maintained with UNDP, which has provided support for the technical co-operation activities carried out under the programme. The following activities have been undertaken in this context:

Asian and Pacific region: Mobile seminars on general management with a small team of lecturers were organized in Shanghai, China and in Pyongyang, Democratic People's Republic of Korea, for groups of local participants (1987). Following the recommendation adopted by the Committee on Invisibles and Financing related to Trade at its twelfth session in March 1987, a first series of seminars in risk management were conducted in January 1988 in six East Asian countries or territories (Malaysia, Hong Kong, Republic of Korea, the Philippines, Singapore and Thailand) support being provided in the framework of a regional project. A Round Table on insurance education and regional insurance co-operation was held in Bangkok, Thailand, (July 1987), being attended by high-level government officials in charge of insurance supervision as well as by top executives from insurance and reinsurance institutions from 16 developing countries of the region. Another project provided for two seminars in Manila, Philippines, for officials of insurance commissions in the ASEAN countries, the first one on motor insurance and the second on mergers and other changes in the structure of the market (1987). The secretariat is also organizing a series of seminars for the staff of the ASEAN Insurance Commissions. Two seminars have been held in 1989, one in Manila and the other one in Singapore. A third seminar will be held in Bangkok in 1990.

19. In addition, the Programme on Insurance provided consultancy services in Qatar on the feasibility of a regional reinsurance company and on laws for compulsory motor insurance. It provided consultancy services to Oman on the feasibility of a regional reinsurance company and to Bahrain regarding the development of an offshore captive insurance market. Consultancy services were also provided to the Asian Reinsurance Corporation in Bangkok. Most of these consultancy services were funded by the recipients.

African region: Under a project providing preparatory assistance for the elaboration of a regional insurance educational strategy and the setting-up of a training centre in Eastern and Southern Africa, a Conference was held in Addis Ababa, Ethiopia, in September 1988. Official representatives of Ethiopia, Kenya, Lesotho, Seychelles, United Republic of Tanzania, Zambia and Zimbabwe agreed on the establishment of a regional training centre. In the framework of another project with the objective to strengthen African insurance markets and enhance regional co-operation, a seminar discussing ways to promote insurance in the rural population through insurance co-operatives

was held in Dakar, Senegal (1988). As part of the same project, a meeting with the objective to increase regional co-operation in the field of reinsurance was held in Cairo, Egypt, in 1988. The meeting brought together top executives from reinsurance companies for the purpose of exchanging reinsurance business. A workshop reassessing African insurance markets will take place in 1990 in the framework of the same project. Objectives of the workshop will be a critical evaluation of the industry's performance over the last decade and the setting up of guidelines for the future.

20. At the country level, the following assistance using UNDP resources was provided to:

(a) Kenya: sectoral support was provided for the training of the staff of the newly-created insurance department;

(b) Maldives: sectoral support was provided to the Government in connection with the establishment of a State-owned insurance institution and the organization of a training programme;

(c) Zimbabwe: sectoral support was provided for the training of the staff of the newly-created insurance department.

Chapter III

FUTURE WORK

21. Within the broad mandates for the work of the Committee in the field of insurance, responses to the challenges posed by new development initiatives and orientations of many developing countries will need to be developed. These have also to take account of the worsened economic situation facing most developing countries. The wording of the Committee's agenda in the field of insurance has traditionally been phrased very broadly so as to allow the Committee great flexibility in choosing the issues which it finds susceptible to analysis, discussion and negotiation. The Committee might wish to identify a number of issues which at this juncture appear to be of special relevance and which it might therefore wish to examine in some depth. In order to stimulate thinking on such questions, the following paragraphs sketch out briefly a number of topics. While certainly not constituting an exhaustive list of problems which might be addressed in an international forum such as the CIFT, they represent concrete areas of inquiry where improved policies could contribute to a strengthening of insurance markets of developing countries.

A. Restructuring of insurance markets

22. Insurance markets in many developing countries may undergo rapid transformation due to changes in policy orientations adopted in developing countries which have a bearing on the financial and insurance sectors of their economies. Among changes of great potential impact are Government decisions to abandon the monopoly of State insurance companies and to encourage a greater number of insurance entities to enter the market and to compete for business. Insurance markets of developing countries may also be affected by the outcome of negotiations in the Uruguay Round of a multilateral framework for trade in services, which could eventually lead to a greater degree of liberalization of insurance markets. In this context, developing countries may wish to examine the impact of providing greater access for foreign insurance suppliers in their domestic markets. A number of questions therefore arise. Among them is the question of how far increases in efficiency, which may be expected from more vigorous competition in national markets, are offset by negative effects. The latter may emanate for example, from the fact that insurance companies of developing countries are often under-capitalized and thus do not yet have sufficient capacity to compete with the subsidiaries of foreign companies. Questions of how much competition should be welcomed and how far the "infant industry" argument still keeps its validity in certain insurance markets of developing countries could also be addressed. Other questions which might be considered concern possibilities to expand the capacity of markets, the optimal number of companies in view of the need for adequate capitalization and reserves, and issues relating to possibilities for a rationalization of their performance in tune with the growth-oriented strategies of developing countries. An in-depth analysis of these issues might provide new insights which could prove useful to policy-makers in developing countries when faced with the need of decision-making in these areas.

B. Extending insurance cover to productive entities of the traditional sector, in particular to agricultural production

23. As the general policy lines adopted by many developing countries are based on efforts to provide closer linkages between the modern and the traditional sector, the insurance industry might want to reflect on possibilities to provide its specific contribution to these efforts. Two areas for consideration may be singled out in this respect. One relates to the initiatives of many developing countries to revitalize their agricultural sector, the other to initiatives to provide incentives for the establishment of small-scale industries, based on local (often agricultural) resources and producing for the needs of the domestic population. The following questions may be considered in this context: How could the insurance industry best support these efforts? Which types of cover could be developed and/or introduced? Are there relevant experiences of developing countries regarding covers that have proved useful for agricultural production and which can be offered by the insurance industry on a long-term basis? Do the latter lend themselves to more universal adoption? What are the possibilities for countries of establishing crop insurance organizations, to be operated through regional reinsurance organizations? How far is Government support needed? Which experiences exist for co-operation between the Government and private industry and how far would they be worthwhile for consideration also by other developing countries? Analysis of such questions is in compliance in particular with the mandate of CIFT to assist developing countries in devising - within the means available to them - insurance schemes better suited to their basic needs, taking into consideration their social, economic, and cultural characteristics. Within this overall context, questions relating to the introduction of more effective risk management methods for agricultural production might also be addressed.

C. Increasing insurance awareness

24. Questions relating to insurance awareness in developing countries might also be considered. Increasing this awareness is necessary for several reasons. One is linked to the fact that insurance markets of developing countries cannot significantly expand if they continue to be mainly focused on the urban population. Another reason is that traditional forms of social "insurance" which used to be provided by the extended family are rapidly disappearing in developing countries and need to be replaced by modern forms of insurance. How can new strata of the population be acquainted with the latter? How far can the educational system be charged with transmitting a basic knowledge of the need for insurance and the services it can offer? Are insurance co-operatives a useful means to reach the rural population?

D. Effective insurance regulation and supervision

25. Sound insurance regulations and effective supervision are indispensable to ensure the orderly functioning of insurance markets. In countries marked by rapid economic and social transformations there is a need for flexibility in adapting such regulations to changing conditions. How can a sufficient degree of flexibility be achieved which is compatible with the necessary stability and reliability of such regulations? Questions which might be addressed in this context are, for example, how considerations to ensure a sufficient long-term profitability of the insurance industry can be combined with concern for consumer protection? The Committee might wish to analyse in

this context some problem areas and discuss experiences of countries where balanced solutions have been found. Questions may also relate to the need to achieve a certain harmonization of regulations in view of the growing international co-operation within the insurance industry. The Committee might also look into some issues associated with the stubborn problems confronting many supervisory authorities in developing countries regarding an improvement of their effectiveness.

E. Reinsurance security

26. The Committee may wish to follow up on its consideration of reinsurance security in developing countries and on any action the Committee may have taken in this respect. It may wish to consider the need for further exchanges of views and experiences regarding measures within the realm of authorities that effectively support insurance companies of developing countries in improving the security of their reinsurance.

Notes

1/ Rules of procedure of the main Committees of the Trade and Development Board (TD/B/740), p. 33, paras. 1 and 3.

2/ The text of the resolutions adopted up to the eleventh session of the CIFT is reproduced in the booklet entitled "The activities of UNCTAD's Special Programme on Insurance", Geneva, 1986.

3/ Resolution 31 (XII).